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ABSTRACT

The booklet presents an historical narrative of banks and banking events leading to the establishment of the Federal Reserve System in 1914. The document is divided into three chapters. Chapter I discusses attempts to establish a bank before the 20th century, describing the creation of two central banks whose chapters were allowed to lapse, the First Bank of the United States in 1791, and the Second Bank of the United States in 1816. It hypothesizes that the National Banking Act of 1863 was inadequate because it failed to provide a central banking structure and, further, that the financial panics and economic depression which followed this act were triggered by inelastic currency and immobile reserves. Chapter II details financial reform in the 20th century, concentrating on the activities of the 1908 National Monetary Commission, and the pros and cons of the Aldrich plan of 1911. It also traces how the Pujo hearings investigating the "money trust," and the election of Woodrow Wilson led to the Glass-Willis proposal in 1912. Also described are the introduction of the Federal Reserve bill into Congress in 1913, and the ensuing political struggle, compromises, and final adoption. Chapter III outlines the establishment of the system, including selection criteria for each of the 12 regional centers, organization of national banks into formal membership, election of local directors, and Wilson's appointment of and Congressional ratification of the Federal Reserve Board. Concluding comments recount how, on November 16, 1914, the Federal Reserve banks opened, without permanent headquarters and with very little business. (CK)

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Historical Beginnings ... The Federal Reserve

SP 011 885

by Roger T. Johnson

Federal Reserve Bank of Boston

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COVER: The signing of the Federal Reserve Act by President Woodrow Wilson, December 13, 1913, is depicted in this painting by Wilbur G. Kurtz, Sr. Commissioned by the Federal Reserve Bank of Atlanta in 1923, the painting is presently on loan to the Federal Reserve Board of Governors in Washington, D.C. from the Woodrow Wilson Birthplace Foundation in Virginia. While more people were present at the actual signing of the Act, Mr. Kurtz chose to picture the following men. Left to right: Lindley M. Garrison, Secretary of War; Josephus Daniels, Secretary of the Navy; Franklin K. Lane, Secretary of the Interior; A.S. Burleson, Postmaster General; Senator Robert Owen, Chairman of the Senate's Banking and Currency Committee; Champ Clark, Speaker of the House; William G. McAdoo, Secretary of the Treasury; Woodrow Wilson, President of the United States; Representative Carter Glass, Chairman of the House Committee on Banking and Currency; Representative Oscar W. Underwood; and William B. Wilson, Secretary of Labor.

Courtesy, Woodrow Wilson Birthplace Foundation

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Federal Reserve Board members, 1914.
Seated left to right: C.S. Hamlin, Governor;
W.G. McAdoo, Secretary of the Treasury
and Chairman;
F.A. Delano, Vice Governor
Standing left to right: P.M. Warburg;
J.S. Williams, Comptroller of the Currency;
W.P. Harding; and A.C. Miller

Courtesy, Federal Reserve Board of Governors, Washington, D.C.

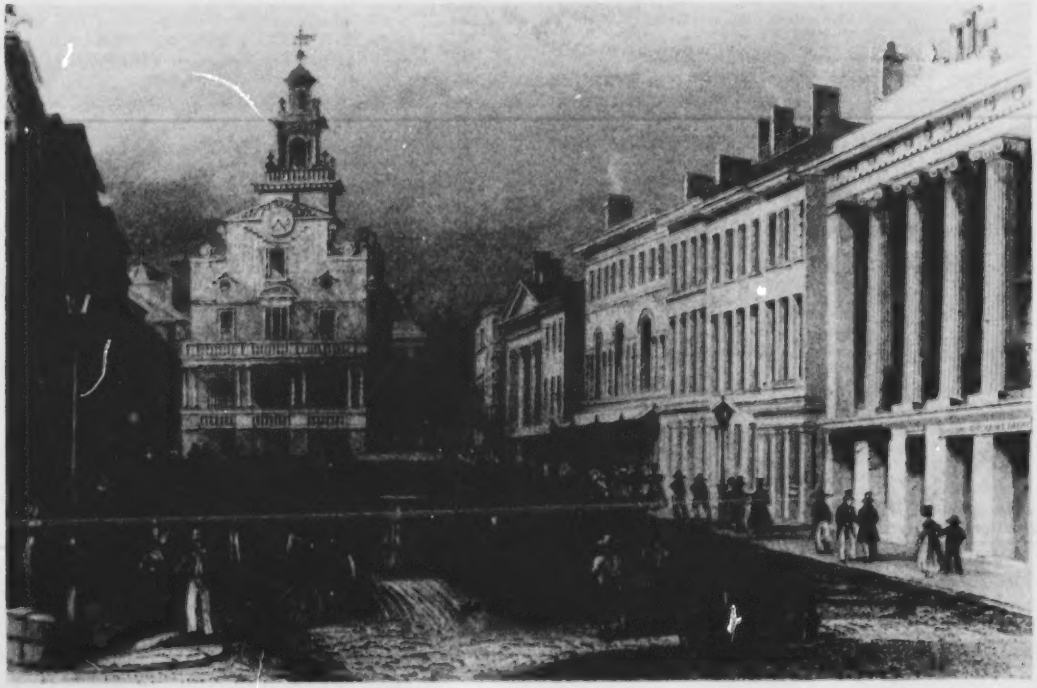
Introduction

At 6:00 P.M. on December 23, 1913, President Woodrow Wilson entered his office. He was smiling as he looked around the circle of friends and associates who had assembled there. Spotting Carter Glass, the slightly built but exceedingly influential congressman from Virginia, at the far end of the room, the President beckoned him to join Senator Robert Owen of Oklahoma at his side. After shaking Glass's hand warmly, the President sat down at his desk and, using four gold pens, signed into law the Federal Reserve Act. As Arthur S. Link, Wilson's principal biographer, has written, "Thus ended the long struggle for the greatest single piece of constructive legislation of the Wilson era and one of the most important domestic Acts in the nation's history."[1]

With this law, Congress established a central banking system which would enable the world's most powerful industrial nation to manage its money and credit far more effectively than ever before. As essential as our central banking system appears to be in the complex economy of the 1970s, the political and legislative struggle to create the Federal Reserve System was long and often extremely bitter, and the final product was the result of a carefully crafted yet somewhat tenuous political compromise.

Indeed, until nearly the beginning of the twentieth century the United States had been a nation dominated by its frontier and its enormous expanse of rich and fertile land. Born in the dawn of the modern age, the United States in its first decades was a land of small farms and nearby towns with few cities of any consequence, and the young nation seemed far more interested in becoming a successful experiment in democracy rather than an economic power. As a result, the institutions necessary to a commercial society—large cities, a common medium of exchange, and a mechanism to regulate that medium—were greeted with indifference if not outright hostility.

Yet, America's very success as an experiment in democracy, and its tremendous agricultural production, provided the base for an urban and, ultimately, an industrial society. "The United States was born in the country and has moved to the city," Professor Richard Hofstadter wrote.[2] Yet, some of the young nation's most eloquent leaders were strong champions of the agrarian way of life who disdained urban life, and the continuing conflict between rural values and urban reality has been one of the most important themes of American history.



State Street in 19th century, Boston

Courtesy, Boston Public Library, Print Department

Chapter 1 Early Experiments in Central Banking

1791: THE FIRST ATTEMPT

This conflict between rural values and urban reality was sharply etched in the first major political controversy following the ratification of the Constitution in 1789, a controversy, in the first years of George Washington's presidency, which dealt with the myriad of issues regarding the monetary and fiscal powers of the new federal government. Secretary of the Treasury Alexander Hamilton advocated the creation of a central bank, a Bank of the United States, to manage the government's money and to regulate the nation's credit. Secretary of State Thomas Jefferson strongly disagreed, arguing that since the Constitution did not specifically empower the Congress to create a central bank Congress could not constitutionally do so. Hamilton responded that Congress could create just such a bank under the constitutional clause giving it all powers "necessary and proper" to the exercise of its specifically enumerated responsibilities; since Congress had been given so many monetary and fiscal powers, Hamilton argued, it would be perfectly proper for it to create a central bank to carry them out. Hamilton won the argument, and the First Bank of the United States was created in 1791.

N.C. Wyeth's Alexander Hamilton Mural,
painted for the Federal Reserve Bank of Boston in 1922
Courtesy, Federal Reserve Bank of Boston

Alexander Hamilton

Thomas Jefferson
Courtesy, Library of Congress

James Madison
Courtesy, Library of Congress

Andrew Jackson

The First Bank of the United States had a capital stock of $10 million, of which $2 million was subscribed by the Federal government, while the remainder was subscribed by private individuals. Five of the twenty-five directors were appointed by the United States government, while the other twenty were chosen by the private investors in the bank. It was not only easily the largest bank of its time, but it was also the largest corporation in the United States; it was a nationwide bank, headquartered in Philadelphia but with branches in other major cities, and it performed the basic banking functions of accepting deposits and issuing bank notes, of making loans and of purchasing securities.

Its power made it useful to American commerce and to the Federal government but frightening to many of the American people. Its charter ran for twenty years, and when it expired, in 1811, Jefferson's Virginia colleague, James Madison, was President. An opponent of the initial bill in 1791, Madison, like many other Jeffersonian Republicans, had changed his mind, and now subordinated his initial constitutional objections and favored the bank's recharter on the grounds of economic expediency. The vote in Congress was extremely close, but the bill to recharter the bank failed in both houses by the margin of a single vote.

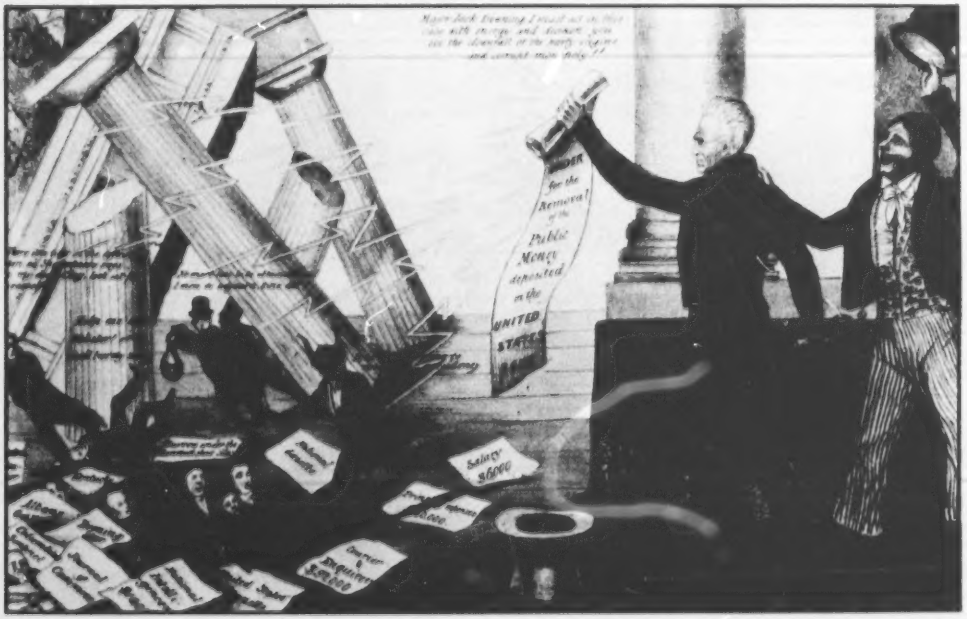
Chaos quickly ensued, brought on by the disruptions of the War of 1812 and by the lack of a central regulating mechanism over banking and credit. State-chartered private banks proliferated, and issued a bewildering variety of bank notes that were sometimes of little value. Moreover, the federal government lacked a safe repository for its own funds, a reliable mechanism to transfer them from place to place, and adequate means to market its own securities.

1816: THE CONTROVERSIAL SECOND BANK

By 1816, Madison's final year as President, a bill to charter a Second Bank of the United States was introduced in Congress. Henry Clay, Speaker of the House, had opposed recharter of the first bank five years earlier on the grounds that Congress had no right to charter such an institution. "The force of circumstance and the lights of experience," Clay now said, persuaded him that Congress did have this power. Enough other congressmen felt the same force and saw the same light so that the bill chartering the Second Bank of the United States narrowly passed both houses and received the President's signature.

The Second Bank of the United States was very much like the first, except that it was much larger; its capital was not $10 million but $35 million. Like the first, one-fifth of the stock was owned by the federal government and one-fifth of the directors were appointed by the President; also, like the first, the charter was to run for twenty years.

So powerful was the Second Bank of the United States that many citizens, politicians, and businessmen came to view it as a threat to themselves and as a menace to American democracy. Andrew Jackson, who became President in

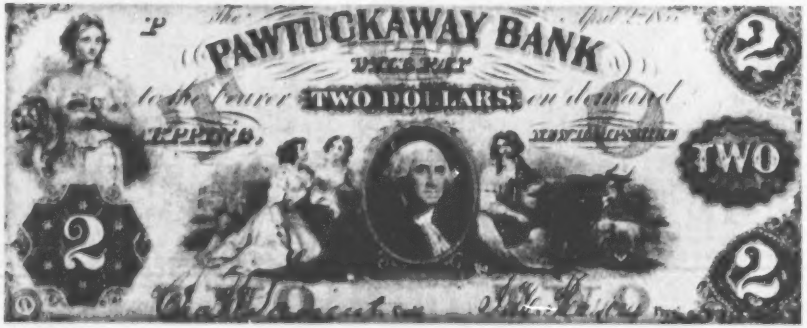


"The Downfall of Mother Bank"
Courtesy, New York Historical Society, New York

1829 when the charter still had seven years to run, made clear his opposition to the bank and its recharter. Jackson has occasionally been labeled an economic illiterate, and it does appear that he neither understood nor sympathized with the functions of money and banking. Nevertheless, many diverse groups in the nation feared the bank's power and supported Jackson's opposition to it. It was essentially the bank's vast economic power which made it politically vulnerable. State-chartered banks, farmers, businessmen on the rise, and many politicians saw the bank as a giant monster standing in their way.

Despite the deep opposition to the bank, Henry Clay, Jackson's opponent in the 1832 presidential election, was able to push a bill through Congress to recharter the bank and intended to use Jackson's veto of the bill as a campaign issue. Jackson's powerful veto message denounced the bank as unconstitutional and described the dangers of "such a concentration of power in the hands of a few men irresponsible to the people." Though the President was on shaky grounds in challenging the bank's constitutionality (the Supreme Court in the famous 1819 case of McCulloch v. Maryland had specifically affirmed the constitutionality of the bank), his attack on the bank's power touched a popular nerve. Clay and his supporters widely circulated Jackson's veto message, but they greatly misjudged the popular response to it, and the President's impressive victory in the election was the beginning of the end of the Second Bank of the United States. When its charter expired in 1836, it ceased its role as America's central bank.

For the next quarter century America's banking was carried on by a myriad of state-chartered banks with no federal regulation. Although in some areas of the country such as New York, New England and Louisiana, the area banking system functioned with restraint, in other areas of the country, banking was not so stable, and the difficulties in American finance hampered the stability of the American economy. Under this system of state-chartered banks exclusively, there were often violent fluctuations in the amount of bank notes issued by banks and the amount of demand deposits (that is, checking account deposits) held by banks. The bank notes, issued by the individual banks, varied in quality from the relatively good to the unrelievedly bad. Finally, this banking system was hampered by inadequate bank capital, risky loans, and insufficient reserves against the bank notes and demand deposits.



Bank Note from Pawtuckaway Bank, Epping, New Hampshire
Courtesy, Federal Reserve Bank of Boston

1863: THE NATIONAL BANKING ACT

During the Civil War Congress passed the National Banking Act of 1863, along with major amendments in 1864 and 1865, and this legislation brought a much greater measure of clarity and security to American banking and finance. Basically, the legislation provided for the creation of nationally-chartered banks (all such banks are recognized by the word "National" or the letters "N.A." — which stand for "National Association" — in their title), and, by effectively taxing the state bank notes out of existence, the legislation in reality provided that only the national banks could issue bank notes.

The legislation also provided stringent capital requirements for the national banks, and mandated that the circulating bank notes be backed by holdings of United States government securities. Other provisions dealt with lending limits, examinations by the newly-created office of the Comptroller of the Currency, and reserves against both notes and deposits. To the surprise of many who had supported the national banking legislation, state-chartered banks were able to survive even though they no longer had the incentive to issue bank notes mainly because the use of checks was increasing rapidly. As a result, demand deposits (checking accounts) and not bank note issues became the most important source of funds to the banks.

The Abraham Lincoln Mural, by N.C. Wyeth
painted for the Federal Reserve Bank of Boston in 1922
Courtesy, Federal Reserve Bank of Boston

"The ten o'clock terrors who never made errors": check clearing in the 1860s
Courtesy, Boston Clearing House
Federal Reserve Bank of Boston Archives

Yet the national banking legislation of the 1860s ultimately proved inadequate. Though it provided for the national chartering of banks and national bank notes, it still did not provide the essentials of central banking. Accordingly, banking remained essentially a local function without an effective mechanism which would regulate the flows of money and credit and which would assure the security of the nation's system of finance. What institutional arrangements on a national level that were to develop in the next half-century (correspondent relationships and check clearing operations, for example) grew up in the vacuum of federal activity; such arrangements were private and quite beyond the control or regulation of national policy.

The first Wells Fargo office, San Francisco, California
Courtesy, Wells Fargo Bank, History Room, San Francisco

BANKING PROBLEMS PERSIST

In the absence of a central banking structure, America's financial picture was increasingly characterized by inelastic currency and immobile reserves. The national bank note currency, secured by government bonds, grew or contracted in response to the realities of the bond market rather than in response to the requirements of American business. The amount of currency in circulation, therefore, depended upon the value of bonds which the national banks held rather than upon the needs of the economy. Such inelasticity in the currency tended to aggravate matters rather than alleviate them, causing the economy to gyrate wildly and somewhat uncertainly between booms and busts.

This Dakota bank, pictured in 1877, was the forerunner of the First National Bank of the Black Hills, Deadwood branch
Courtesy, West Glen Communications, New York

Courtesy, *Philadelphia Record*

Moreover, under the national banking system the bank reserves were spread around the country, but they tended to be immobile where they sat. There were three types of national banks: country banks, reserve city banks, and central reserve city banks. Country banks (and these were all national banks located in places other than the fifty cities which were reserve and central reserve cities) had to keep part of their reserves in the form of vault cash, and the rest in the form of a deposit with a national bank in a reserve or central reserve city. Reserve city banks (and these were all national banks located in 47 specific and generally important cities) had to keep part of their reserves in the form of vault

cash, and the rest in the form of a deposit with a national bank in a central reserve city bank. Central reserve city banks (and these were all national banks within only three cities: New York, Chicago, and St. Louis) had to keep all of their reserves in the form of vault cash.

All this meant that fifty different cities in the nation served as reserve depositories. Even though the total of reserves in the national banking system was very large, the economic value of this reserve was largely mitigated because it was so spread out; it was as if the American army were scattered all over the country, with each soldier assigned to protect his own specific area of several square miles. Such an army would clearly be infinitely less powerful than one whose forces were all gathered in a few strategic locations. The reserves of money could not be shifted easily to areas of the country needing them.

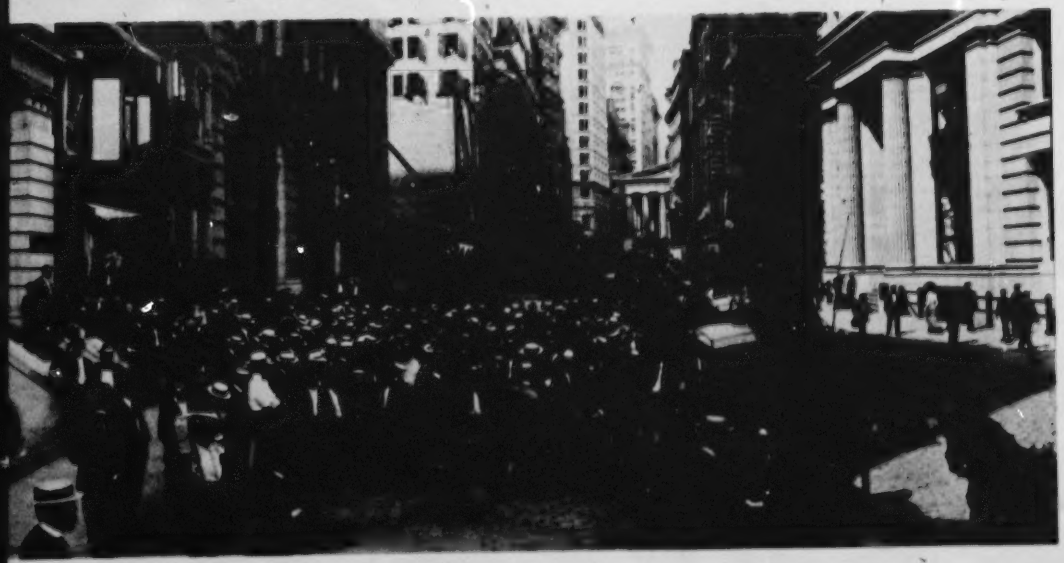
Also, the fact that reserve city banks held reserves for the country banks, and that their own reserves were held by central reserve cities, meant that the central reserve city banks, and particularly those in New York, were unusually sensitive to the demands for currency from the country banks. When the country banks needed currency, particularly during the crop selling season, those banks would get their currency by drawing down their reserve accounts with their reserve city banks. Those banks, now with less vault cash, were compelled to draw down their own reserve accounts with their central reserve city banks. It was much like a whip, where a little force at one end produced a tremendous force at the

Wall Street's curb market, 1902
Courtesy, Library of Congress

other; demands for currency from the country banks often put inordinate pressure upon the central reserve city banks.

As America's industrial economy became larger and more complex in the waning years of the nineteenth century and the early years of the twentieth, these weaknesses in the national banking system — inelastic currency and immobile reserves — became increasingly more critical. It had become clear that the national banking system did not provide the regulating mechanism for money and banking that the two Banks of the United States had provided early in the nation's history. And as the American economy became larger, more urban, and more complex, the inelastic currency and the immobile reserves contributed to the cyclical pattern of booms and busts. These wide gyrations were becoming more and more intolerable.

Financial panics occurred with some frequency, and they often triggered an economic depression. In 1893 a massive depression rocked the American economy as it had never been rocked before. Even though prosperity returned before the end of the decade — and largely for reasons which this nation could not control — the 1893 depression left a legacy of economic uncertainty.



Chapter 2 Financial Reform in the 20th Century

In 1907 a severe financial panic jolted Wall Street and forced several banks into failure. This panic, however, did not trigger a broader economic collapse. Yet, the simultaneous occurrence of general prosperity with a crisis in the nation's financial centers did persuade many Americans that their banking structure was sadly out of date and in need of major reform.

Bank run in the early 1900s
Courtesy, Library of Congress

1908: THE MONETARY COMMISSION

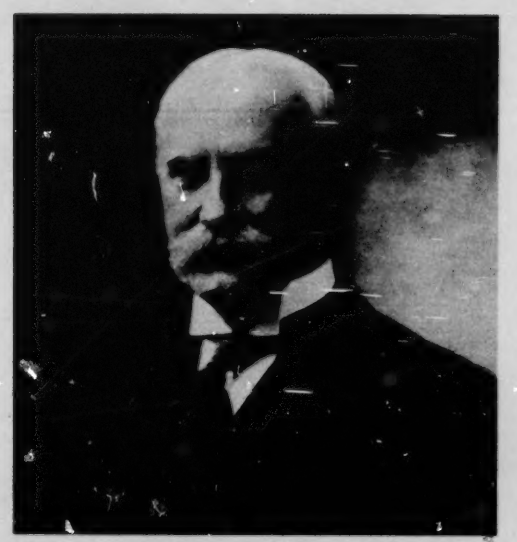
The initial response of Congress was feeble. In 1908 it passed the Aldrich-Vreeland Act, which was designed to make the money supply somewhat more elastic during emergency currency shortages. This was not financial reform but a temporary palliative. Another provision of the law created the National Monetary Commission. This body, composed of nine senators and nine members of the House of Representatives, had the responsibility of making a comprehensive study of the necessary and desirable changes in the money and banking system of the United States.

The chairman and dominant member of the commission was Senator Nelson W. Aldrich of Rhode Island, the single most powerful member of the United States Senate and a pillar of the eastern establishment. Aldrich's prominence and power sharply reflected the political controversies of the period. In the 1890s the rural populists of the South and West had challenged the institutions and the power of finance and business, for they felt that the wealth and "special privileges" enjoyed by the few were resulting in the exploitation of the many.

In the first decade of the twentieth century, the progressive movement — more broadly based than the populists, better educated, more urban, and more sophisticated in understanding and in using political power — won control of many state governments and elected many senators and representatives. Though the progressive movement comprised a diversity of people and took a variety of forms, its major purpose was to limit and regulate the new aggregations of economic and political power which the growth of industrial America had spawned.

In the bitter controversies between the progressives, who generally represented the small businessman and the small town and farming population, and

"Some Horses Just Fear A Bridle," by J. Darling
Courtesy,
Des Moines Register



Senator Nelson Aldrich
Courtesy, the Rhode Island Historical Society

the conservatives, who generally represented the most powerful business and banking groups of the large eastern cities, Aldrich was a central figure. The Rhode Island senator was one of the most prominent critics of the progressives, and the progressives, in turn, found Aldrich to be one of the most bitter and stalwart champions of American conservatism. (The marriage of Aldrich's only daughter to John D. Rockefeller, Jr., further convinced many Americans that Aldrich was the champion of the rich and financially secure.)

In short, the need for financial reform had become most evident just when the progressives were attempting to limit the power of the financial community. While most bankers were interested in reforming the financial structure of the nation to make it more efficient and centralized, the progressives were interested in reforming the financial structure by making the banking system less powerful. The National Monetary Commission, under Aldrich's direction, was empowered to undertake a broad study of the nation's financial needs; while the bankers generally applauded the Commission, the progressives viewed it with suspicion, believing that anything that Aldrich and the banking community supported would serve their narrow interests rather than the interests of the American people.

"It might help some if Wall Street gave trading stamps,"
Puck Magazine
Courtesy, Boston Public Library

BANKERS AND THE ALDRICH PLAN

Over the following three years the National Monetary Commission undertook a broad and exhaustive study of America's financial needs and resources, conducting investigations and hearings in many American cities and visiting many foreign banking institutions. In January, 1911, Senator Aldrich presented to a group of businessmen in Washington his plan for a reform of the nation's banking and financial institutions. This plan, which was so clearly prepared under the influence of large bankers, was strongly attacked by the progressives and never appealed to the public. Moreover, the conservative Republican Aldrich presented his plan just after the election of 1910, in which the Democrats captured Congress for the first time in nearly two decades, while Republican President William Howard Taft, supported by the party's conservatives, was increasingly besieged by the party's progressive wing. In short, Aldrich presented his plan just after his party had suffered a serious rebuff at the polls, and while a President sympathetic to his views was under growing attack within his own party.

The Aldrich plan provided for one central institution, to be called the National Reserve Association, with branches all over the country and with the power to issue currency, and to rediscount the commercial paper of member banks. Control of the institution would reside in a board of directors, the overwhelming majority of whom would be bankers.

The Aldrich plan received scant public support and aroused strong opposition. Many progressives protested that the Aldrich plan would not provide for adequate public control of the banking system, that it would enhance the power of the larger banks and the influence of Wall Street; and that its currency reform provisions would be dangerously inflationary. "Big financiers are back of the Aldrich currency scheme," William Jennings Bryan proclaimed. The Nebraska populist, a three-time Democratic presidential nominee who had based his campaign in 1896 on an attack on the bankers and the deflationary impact of the gold standard, asserted that, if the Aldrich plan were implemented, the big bankers would "then be in complete control of everything through the control of our National finances."

Bryan's denunciation of the Aldrich plan was shared by many leaders of the progressive movement. Though this opposition signaled an early demise for the kind of currency and financial plan that the bankers wanted, two significant events of 1912 helped to prepare the way for passage of a banking and currency reform program which the bankers in general feared, but which the progressives wanted — a reform designed to limit the power of the banking system and put central banking under public, rather than banker, control.

THE "MONEY TRUST"

The first significant event of 1912 was the hearings before the House Banking and Currency Committee, the so-called Pujo hearings, which examined the control of the banking and financial resources of the nation. These hearings, which continued into the early months of 1913, apparently persuaded most of the American people that the ultimate control over America's banking and financial system rested in the hands of a tiny group on Wall Street, the so-called "money trust." In its report, issued in February, 1913, the committee said, "If by a 'money trust' is meant an established and well-defined identity and community of interest between a few leaders of finance . . . which has resulted in a vast and growing concentration of control of money and credit in the hands of a comparatively few men . . . the condition thus described exists in this country today."

President Wilson and President Taft
Courtesy, Library of Congress

The second event of 1912, crucial to financial reform, was the election of Democrat Woodrow Wilson to the Presidency. Elected on a progressive platform, and with a record as a reformist governor of New Jersey, Wilson pledged himself to financial reform without the creation of a central bank. The new President, however, knew very little about banking, and he had to rely upon others for advice on the shape of his reform proposal.

One leading public figure Wilson could not ignore was William Jennings Bryan, and Bryan's views were a strong force in shaping the financial reform program that ultimately became the Federal Reserve System. A three-time Democratic presidential nominee, Bryan had a very wide following in the rural states, and he was a strong and vocal leader of the anti-Wall Street Democrats. At the 1912 Democratic convention he dramatically threw his support to Wilson and received much of the credit for the latter's ultimate nomination. The new President named Bryan his Secretary of State. For years Bryan had a reputation as one of the nation's most outstanding and enthralling public speakers, but some people who knew him best believed that the power of his oratory concealed the paucity of his intellect. One of his cabinet colleagues later

sneered: "I discovered that one could drive a prairie schooner through any part of his argument and never scrape against a fact or a sound statement."[1] As we have already seen, Bryan had strongly opposed the Aldrich plan as just an attempt to give the big bankers even more power; to Bryan, currency reform and curbing the power of the leading financiers were the very same thing. "The currency can be given all the elasticity it needs without increasing the privileges of the banks or the influence of Wall Street," he said at one point.

"He Loves Me, He Loves Me Not"
Puck Magazine
Courtesy, Boston Public Library

Wilson had echoed Bryan's feelings in the past. A year before his election Wilson asserted, "The greatest monopoly in this country *is the money monopoly*," and a few months later he declared that the nation would not accept "any plan which concentrates control in the hands of the banks." It was probably a combination of political realities and his own lack of knowledge about banking and finance that caused Wilson to reflect many of Bryan's views, but after his election to the Presidency, Wilson relied on others for more expert advice on the currency question. Two of his most important advisers were Representative Carter Glass of Virginia, soon to become chairman of the House Committee on Banking and Finance, and the committee's expert adviser, H. Parker Willis (formerly professor of economics at Washington and Lee University, and in 1912, associate editor of the New York *Journal of Commerce*). Throughout most of 1912, Glass and Willis had conferred repeatedly on the currency problem, and Willis finally completed a tentative draft of a bill by the end of October — just a few days before Wilson's victory.

BACK TO THE DRAWING BOARD: THE GLASS-WILLIS PROPOSAL

On December 26, 1912, Glass and Willis traveled to Princeton, New Jersey to lay their plan before the President-elect. Wilson was suffering from a cold and he canceled all of his other appointments, but he insisted that Glass and Willis keep their interview as scheduled. With great enthusiasm the two visitors presented to Wilson their plan for reforming the financial structure (yet avoiding the creation of a central bank under banker domination) and remedying the classic problems of immobile reserves and inelastic money supply. The Glass-Willis proposal called for the creation of twenty or more privately controlled regional reserve banks, which would hold a portion of member banks' reserves, perform other central banking functions, and issue currency against commercial assets and gold.

Wilson liked much of the Glass-Willis proposal, but he wanted something else added — a central board to control and coordinate the work of the regional reserve banks, what he called the "capstone" to the entire structure. At first Carter Glass was appalled by Wilson's proposal, fearing that it would result in the same centralization that he had so disliked in the Aldrich plan, but he kept his views fairly quiet and soon his fears faded away. The "capstone" that Wilson wanted — a Federal Reserve Board — was to be a public agency unlike the banker-dominated central bank of the Aldrich plan. The Glass-Willis proposal of December, 1912, with Wilson's modifications, formed the basic elements of the Federal Reserve Act signed into law in December, 1913.

Nevertheless, from December, 1912, when Wilson first talked with Glass and Willis about currency reform, until December, 1913, when the President signed the Federal Reserve Act into law, the Glass proposal was attacked from two sides: on one side, bankers (especially

Representative Carter Glass
Courtesy, Library of Congress

from the big city institutions) and conservatives thought that the bill intruded too much government into the financial structure, while on the other side the agrarians and "radicals" from the West and South thought that the bill gave the government too little authority over banking. Bryan was the national spokesman for the latter group, and it was his views that Wilson had to face first.

The first action of the new Wilson Administration upon taking office on March 4, 1913, was to work for a downward revision of the tariff. Currency reform would follow as a second item of business. The President recognized that it would be a difficult struggle to get both bills through the Congress, but the Democrats were somewhat more united on tariff reduction than they were on currency reform and so it made political sense to tackle the tariff issue first. Throughout April, May, and June this issue dominated Congress and the President, and through the rest of the summer high-tariff Republican senators (who generally favored the Aldrich plan) dragged out the debate on the tariff in an attempt to delay consideration of the banking bill. On October 3 the major tariff reduction bill was on Wilson's desk, and he signed the new law much to the gratitude of the Democratic progressives.

H. Parker Willis
Courtesy, Washington and Lee University

BATTLE LINES DRAWN

Although placated by Wilson's leadership in the tariff struggle, the Democratic progressives nevertheless were far more concerned about the banking bill that the President was preparing. By the late spring of 1913, Bryan (who was supporting Wilson on tariff reduction) had made clear his opposition to the Glass bill and his determination to give government a larger role over banking and currency than Glass contemplated. Specifically, Bryan thought that the bill gave bankers too much control over the proposed Federal Reserve System, hence failing to weaken Wall Street's credit monopoly, and he believed that the currency should be issued by the government rather than by the reserve banks, as the Glass bill proposed.

"Bryan versus Wilson"
Puck Magazine
Courtesy, Boston Public Library

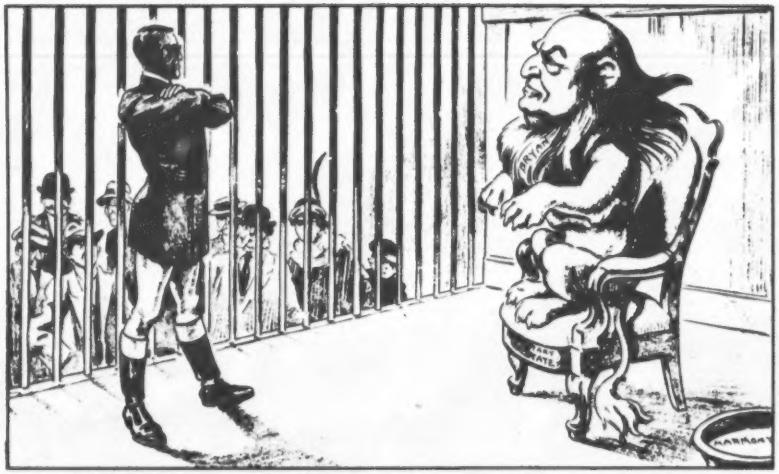
Buffeted by this conflict within his Administration, President Wilson sought a compromise that could please both Glass and Bryan and then win the support of Congress, yet a compromise that would genuinely resolve the banking and currency problem. To sharpen his own thinking, Wilson sought the advice of the man whose opinions on economic matters he respected above all others, the prominent attorney Louis D. Brandeis. Brandeis, a man of undeniable brilliance, sided with Bryan on two key points: first, he believed that bankers must be excluded from control of the new system; and second, he believed that the Federal Reserve currency must be made an obligation of the United States government. "The conflict between the policies of the Administration and the desires of the financiers and of big business, is an irreconcilable one," Brandeis told Wilson. "Concessions to the big business interests must in the end prove futile."[2]

After several conferences, Wilson met on June 17 with Glass, Secretary of the Treasury William G. McAdoo, and Senator Robert Owen of Oklahoma (chairman of the newly created Senate Banking and Currency Committee and a supporter of Bryan's views), and he told them that he would insist upon exclusive government control of the Federal Reserve Board and would insist upon making Federal Reserve notes the obligation of the United States. The former was clearly a victory of substance for the

Bryan group, while the latter point was merely a victory of form.

What Bryan and his followers really wanted was the retirement of national bank notes and their replacement by a supply of paper money issued on the initiative of public officials and backed up only by the government's promise to pay. What Bryan really got, however, was just the addition of relatively meaningless language to the basic provisions of the Glass bill; the Glass bill provided that Federal Reserve notes would be issued by the regional reserve banks against their own commercial assets and a 33 1/3 percent gold reserve, and the change which placated Bryan and other progressives was the mere declaration that these notes were obligations of the federal government. This additional language did not change the essential character of Federal Reserve notes as asset currency. Glass had been initially disappointed with Wilson's request for a public board to control the new system, but seeing that this was the absolute minimum that Bryan demanded, Glass had no real alternative but to accept it.

On June 23, 1913, President Wilson appeared before a joint session of Congress and presented his program for currency reform. With a united Administration now behind him, the President pleaded for a banking system that would provide for an elastic currency and that would vest control in the government, "so that the banks may be the instruments,



Bryan tamed, "Ain't It Wonderful" *Puck Magazine*
Courtesy, Boston Public Library

not the masters, of business and of individual enterprise and initiative."

Most bankers did not like what they heard. Particularly vigorous — and often very bitter — in their opposition were the big-city bankers, especially from New York. Conservatives also lambasted the bill as a radical break in the nation's *laissez-faire* economic policy. The bankers speaking out in opposition, having favored the Aldrich plan of a central bank under banker control, disliked the framework of government regulation, dominated by political appointees. Bankers in the central reserve cities of New York, Chicago, and St. Louis, as well as many bankers in the forty-seven reserve cities, disliked the fact that the new Federal Reserve banks would be the sole

holders of reserves for the national banks. (It will be recalled that under the national banking system, national banks in central reserve cities and reserve cities were reserve depositories for other banks.)

Many bankers with nationally chartered banks disliked compulsory membership in the Federal Reserve System for national banks, and they criticized the bill's assault on "private rights." Finally, many conservatives and bankers were strong Republicans, and they termed the bill a Democratic party measure for the altogether logical reason that it was written and sponsored by a Democratic Administration, and a Democratic Administration apparently dominated by its southern and western, and "anti-business" elements. The *New York Times* referred derisively to the "Oklahoma idea, the Nebraska idea," clearly pointing to Senator Owen and Secretary of State Bryan who, as we have seen, played a major role in writing the bill and adding the government control, through the Federal Reserve Board, which bankers appeared to find most obnoxious.

Continuing its harsh criticism, the *Times* said: "It reflects the rooted dislike and distrust of banks and bankers that has been for many years a great moving force in the Democratic party, notably in the Western and Far Western States. The measure goes to the very extreme in establishing absolute political control over the business of banking." The *New York Sun*, considered by many to be the spokesman for Wall Street at that time, called the bill "this preposterous offspring of ignorance and unreason...covered all over with the slime of Bryanism."

Members of the Boston Clearing House
Courtesy, Boston Clearing House, Federal Reserve Bank of Boston Archives

POLITICAL COMPROMISES

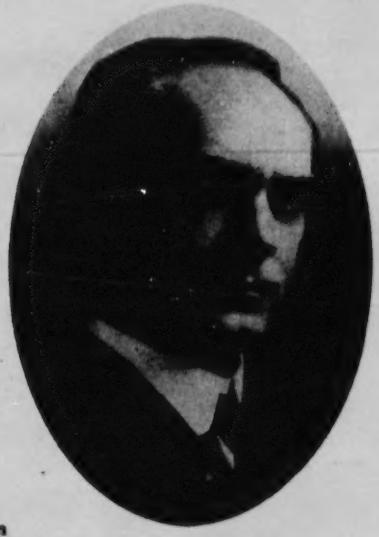
Just as earlier in the year Wilson had moved to still the opposition of Bryan and many progressives, now the President acted to attempt to reconcile the banking community to his currency bill. Accordingly, on June 25 — just two days after the President had presented his bill to Congress — Wilson, along with Glass, Owen, and McAdoo, met with four leading bankers, who represented the currency commission of the American Banking Association. As a result of this conference some important modifications were made in the bill. One provided that national bank notes would be retired gradually, hence protecting the banks' large investments in the bonds that backed this currency; another weakened the Federal Reserve Board's authority over the rediscount rate, giving more responsibility in this matter to the regional reserve banks; finally, the President agreed to accept a Federal Advisory Council, consisting of representatives of the banking community, to serve as a liaison between the reserve banks and the Federal Reserve Board. Despite Wilson's efforts, the bankers at the conference were not satisfied, for they did not get what they wanted — a centralized structure under banker control — and the heart of the bill retained what they did not want — a decentralized structure under public (or, as the bankers put it, "political," meaning Democratic) control.

The next day Glass and Owen introduced the revised Federal Reserve bill in the House and Senate. Despite the continuing banker and conservative opposition, the Wilson Administration was in a strong position to get its currency bill passed through Congress. The Administration was unified in support of the bill, progressive opinion in the country seemed to favor the currency program, and the President's success in the tariff issue demonstrated his strong control over the Democratic majorities in both houses of Congress. For the Democrats, Wilson was their party's first president in sixteen years, and they were reluctant to embarrass him and themselves by resisting a major component of his program.

"Schoolmaster Wilson lays down the law to Congress"
Courtesy, *New York Tribune*

In fact, however, the following months would demonstrate how difficult it was for Wilson to unify his party in Congress behind his program. Shortly after Glass and Owen introduced the bill, a

rebellion broke out among some Democratic congressmen from rural areas in the South and West. Led by Representative Robert L. Henry of Texas (he was, Carter Glass later recalled, "an exceedingly likable fellow; but he knew as much about banking as a child about astronomy"),[3] this group demanded that the Wilson Administration destroy the "Money Trust" before setting out to reform banking and currency. Moreover, these Democratic agrarians disliked the Federal Reserve bill's provision for private control of the regional reserve banks, believing that this would be a private financial trust operating under government protection.



Representative Robert L. Henry
Courtesy, University of Texas at Austin

Most important, however, the dissidents protested that the Federal Reserve bill made no provision of agricultural credit, giving the farmers little hope of eliminating the state of debt that had ensnared them since the aftermath of the Civil War. "The bill as now written," Representative Henry said in July, "is wholly in the interest of the creditor classes, the banking fraternity, and the commercial world, without proper provision for the debtor classes and those who toil, produce, and sustain the country."[4] To sustain his objections, Henry introduced a series of amendments that would prohibit interlocking directorates among the member banks, weaken the structure of the Federal Reserve Board, and alter the currency issues in such a way as to enable farmers to obtain money on far more liberal terms.

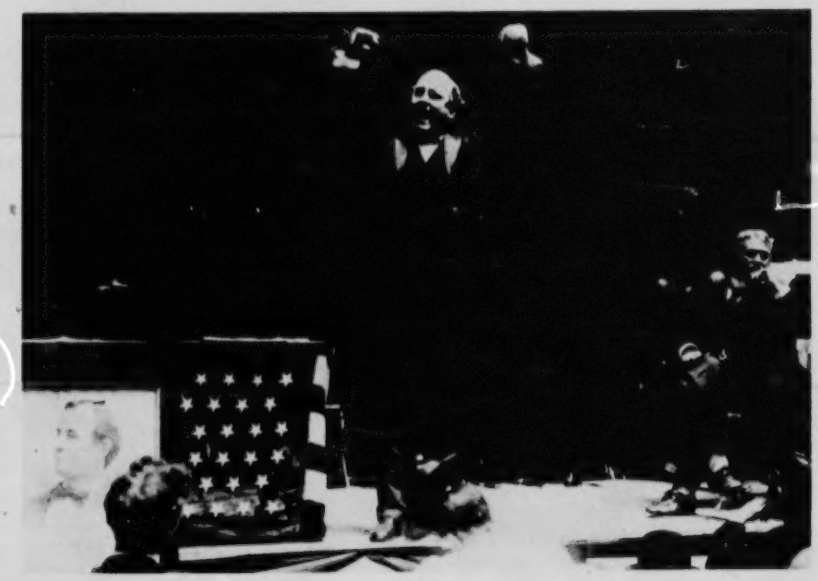
For a while it appeared that the agrarian bloc might be able to kill the Federal Reserve bill. In July they were able to take control of the House Banking and Currency Committee, much to Chairman Glass's despair. Yet the Henry proposals were no more popular with the general public than the Aldrich Plan had been, and many people regarded them as the wildest form of Populism.

Again, President Wilson moved quickly to meet the opposition to the bill. He invited the agrarian leaders to the White House and mollified them, in part at least, by agreeing to work for the prohibition of interlocking directorates among the banks in his forthcoming antitrust bill. With a combination of pleas, promises, and perhaps even threats Wilson was able to beat back much of the opposition from the agrarian bloc,

and in early August the House Banking and Currency Committee reversed the direction it had taken a few weeks earlier and overwhelmingly approved the Federal Reserve bill.

Though beaten in the committee, Representative Henry did not yet give up; he now worked to get the House Democratic caucus to kill or severely modify the Federal Reserve bill. With the agrarian opposition still a threat to the passage of the bill, the most prominent agrarian radical in the country — Secretary of State William Jennings Bryan — moved dramatically to save it. Promising that the Administration would work to deal with the problem of interlocking directorates in the antitrust bill, Bryan asked his friends to stand by the President and support his banking program. Bryan's prestige was so great in the rural areas that his forceful advocacy shattered the radical opposition within the House, and the House Democratic caucus overwhelmingly approved the measure by the end of August. This approval meant that the Federal Reserve bill was a party measure, binding on all House Democrats.

Formal approval by the House Democratic caucus greatly weakened radical agrarian opposition, and was but one of many indications that the Federal Reserve bill was coming to enjoy broader public support. Progressive opinion, in favor of banking and currency reform for several years, endorsed the changes recently made in the bill. Additionally there were strong indications of growing support for the bill among the nation's businessmen, with the small businessmen especially enthusiastic about it. Finally, and perhaps most important, a few fissures had begun to appear in the wall of opposition put up by the nation's bankers. As early as June several leading Chicago bankers had enthusiastically endorsed the measure, and a significant number of the small, country bankers in the South and Middle West were giving the bill their support. Nevertheless, the vast majority of the nation's bankers — country and city — still strongly opposed the bill, often with the bitterest hostility; a San Antonio banker, for example, called the bill a "communistic idea."



Secretary of State William Jennings Bryan
Courtesy, Library of Congress

The 20th century banker
Courtesy, American Bankers Association

OPPOSITION FROM BANKERS

In fact, the strong banker opposition came sharply into view at just about the time the House Democratic caucus was approving the bill. Meeting in Chicago in late August with a commission of the American Bankers Association, the presidents of 47 state banking associations and 191 clearinghouse associations raised many objections to the Administration's banking reform. They made it clear that they wanted the Aldrich plan, with one central bank generally controlled by bankers and generally independent of government regulation.

According to Wilson's major biographer, Professor Arthur S. Link, the Chicago conference decisively altered the controversy over the banking issue, making the Administration more hostile to the bankers publicly opposing the Federal Reserve bill. Until this time Wilson and his major advisers had believed that the bankers, despite their rhetoric, would in the final analysis work responsibly for the Administration plan. The Chicago manifesto appeared to kill that hope and sharply etched the broad differences between the majority of the banking community and the Wilson Administration. From then until final passage of the Federal Reserve bill in December the Wilson Administration tended to regard banker opposition as essentially irreversible.

PASSAGE BY CONGRESS

With the hope that strong public support for the measure would neutralize banker opposition, Carter Glass began to push the bill through the House in early September, and on September 18 the House overwhelmingly approved it by a vote of 287 to 85. Though this vote was a clear victory for Wilson, significant partisan division was also manifest; all but three Democrats supported the bill, while seven out of every ten Republicans opposed it. (It should be noted that most far-reaching bills pass Congress with some partisan division, but if the law proves to be successful it ultimately comes to command broad, bi-partisan support; the Federal Reserve is certainly no exception to this.)

Passage by the House was only half the battle, and apparently the easier half; indeed, the Senate scene was so confused that it was impossible to predict the outcome. Senator Owen, chairman of the Senate Banking Committee, was an uncertain reed of support for the Glass bill. Originally he had surrendered his own bill to co-sponsor the Federal Reserve bill with Glass, yet at the time of the House caucus in August he publicly assailed the bill's regional basis and its provision for mandatory membership for national banks. Summoned to the White House by Wilson, Owen publicly recanted his criticism of the bill, but his erratic behavior gave the measure's supporters many uneasy moments.

In addition to uncertainty about Owen's support and doubts about his effectiveness, the Administration was further weakened in the Senate because its tactics backfired badly. Earlier in the session the Administration had gotten the tariff bill through both House and Senate without any committee hearings, on the grounds that previous lengthy consideration of tariff reduction made more hearings unnecessary. The Administration used the same argument on the Glass bill, and it had worked in the House where no hearings were held. The Senate, however, rejected the Administration position and voted to hold full-scale hearings on the banking measure. Not only would extended hearings delay — and perhaps endanger — ultimate passage of the bill, but the hearings would be conducted by the Senate Banking Committee, where President Wilson had less support among Democrats than he had in the Senate as a whole.

Senator Robert L. Owen
Courtesy, Oklahoma Historical Society

Indeed, three of the seven Democrats on the Senate Banking Committee — Gilbert Hitchcock of Nebraska, James O'Gorman of New York, and James Reed of Missouri — appeared ready to combine with the Republican minority in an effort to drag out the hearings and perhaps ultimately kill the bill by slow strangulation. As a result the hearings, begun in September, wore on into October, and they became a forum for the bill's opponents of both the right and the left. Banker opposition was especially vocal and vigorous. In early October, a few weeks after the House had overwhelmingly approved the bill and while the Senate hearings were continuing, the American Bankers Association held its annual convention in Boston and passed

Program cover, American Bankers Association meeting in Boston
Courtesy, Federal Reserve Bank of Boston Archives

a series of resolutions denouncing the Federal Reserve bill as socialistic, confiscatory, unjust, un-American, and generally wretched.

Wilson's perception of these events was that the three Democratic senators, the Republican minority, and the largest bankers had joined in a conspiracy to kill his banking reform plan. Despite his intense irritation at the obstructionist tactics of the three Democratic senators, the President ultimately came to use the same tactics on them that he had used with such effectiveness on the House rebels; he called them into personal consultation at the White House and used a combination of pleas and promises to try to win their support, or at least their neutrality. Wilson agreed with them that the bill might have to be amended further, and this helped mollify the dissident senators.

In late October, and with dramatic suddenness, Wilson's hopes for an accommodation were almost killed. Frank A. Vanderlip, president of the National City Bank of New York, appeared before the Senate Banking Committee and proposed an entirely new banking and currency plan, which he had prepared at the request of Senators Hitchcock, Reed, and O'Gorman, the committee's three Democrats. The Vanderlip plan called for the establishment of one Federal Reserve Bank with the capital to be subscribed by the public, the government, and the national banks. The central Federal Reserve Bank would have twelve branches around the country. Control of the bank would rest entirely in the hands of the

federal government, and the bank could issue currency against its commercial assets and a 50 percent gold reserve.

This bill managed to have an appeal both to the agrarian radical opponents on the left and the banker opponents on the right. Many progressives and agrarian radicals liked the thoroughgoing governmental control in the Vanderlip plan, while many conservatives liked it because it provided for just one central bank. Some supported the Vanderlip plan because it appeared to restrict the power of private bankers and Wall Street, while others supported it because it appeared to put the control of banking into the hands of bankers. Finally, the fact that the public could buy stock in this bank (in contrast with the Federal Reserve bill, which provided that only member banks could buy capital stock in the regional banks) gave the bill added public appeal. Within a few hours of its introduction eight of the twelve members of the Senate Committee supported the Vanderlip plan.

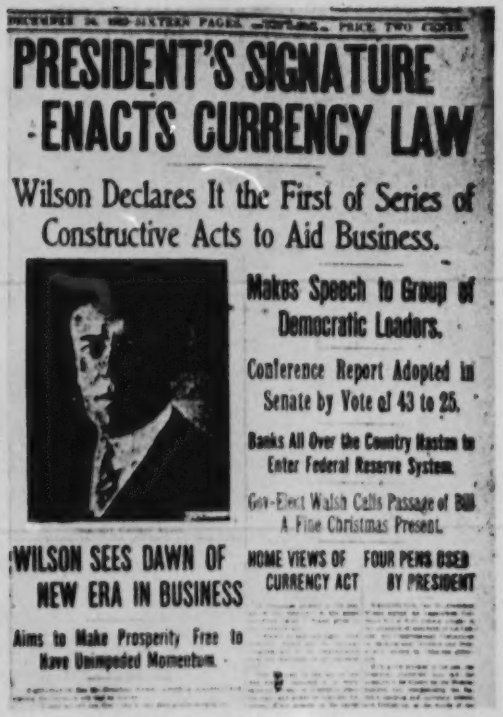
Wilson voiced immediately his strong and uncompromising opposition to the Vanderlip plan, and, with his great popularity, this played a major role in weakening its public appeal. Under strong and continuing Administration pressure, O'Gorman and Reed were gradually moderating their opposition to the Federal Reserve bill, and by early November they finally came to publicly support its main features. Ultimately, in late November, the Senate committee reported two different bills to the full Senate — a slightly amended Federal Reserve bill, and the Vanderlip plan. The result of this maneuver was to break the hold which the Senate committee had exercised over the Federal Reserve bill.

Continuing public support for the Federal Reserve bill hastened final Senate action in December. Respected conservatives continued to speak in opposition — Republican Senator Elihu Root of New York called the bill "financial heresy" — but they were overshadowed by the steady support from Progressive leaders, and the growing support for the bill among organized business opinion and a growing minority of bankers. On December 19 the critical vote was taken in the Senate, and the Federal Reserve bill was narrowly preferred over the modified Vanderlip plan by a margin of only three votes, 44 to 41. A few hours later the Senate passed the Federal Reserve bill itself, 54 to 34. As in the final House vote

Frank A. Vanderlip
Courtesy, Citibank, New York

partisan division was evident, but it was even sharper in the Senate; all Democrats supported the measure while all but six Republicans opposed it.

The House and Senate versions of the Federal Reserve bill varied slightly, so the two bills went to a conference committee, composed of members from both houses, to resolve the differences. For example, the House bill had provided that at least twelve regional reserve banks be created, but the Senate bill provided that the number of reserve banks be no fewer than eight but no more than twelve; the



PRESIDENT'S SIGNATURE ENACTS CURRENCY LAW

Wilson Declares It the First of Series of Constructive Acts to Aid Business.

Makes Speech to Group of Democratic Leaders.

Conference Report Adopted in Senate by Vote of 43 to 25.

Banks All Over the Country Hasten to Enter Federal Reserve System.

Gov.-Elect Walsh Calls Passage of Bill A Fine Christmas Present.

WILSON SEES DAWN OF NEW ERA IN BUSINESS

Aims to Make Prosperity Free to Have Unimpeded Momentum.

HOME VIEWS OF CURRENCY ACT

FOUR PENS USED BY PRESIDENT

President Wilson signs the Federal Reserve Act
Courtesy, Boston Public Library

conference committee accepted the Senate version on this matter, yet the House conferees prevailed on some other points. In contrast with the months of congressional wrangling before the two bills were passed, the conference committee resolved the minor differences between the two measures in only two days, and both the House and Senate quickly approved the compromise measure.

On December 23, just a few hours after the Senate had completed action, President Wilson, surrounded by members of his family, his cabinet officers, and the Democratic leaders of Congress, signed the Federal Reserve Act. "I cannot say with what deep emotions of gratitude...I feel," the President said, "that I have had a part in completing a work which I think will be of lasting benefit to the business of the country."

The Federal Reserve Act was now law, and of all the men who deserve credit for this major reform of America's banking and currency system — Nelson Aldrich, Carter Glass, Robert Owen, William McAdoo, H. Parker Willis, and even William Jennings Bryan — none deserves more credit than President Wilson himself. Withstanding the contrary demands of the private bankers on the one hand and the agrarian radicals on the other, the President had supervised the development of a bill and had skillfully commanded Democratic support for it and led it through the congressional thicket. The passage of the Federal Reserve Act stands as almost a textbook case of wise and skillful presidential leadership over Congress.

Chapter 3

Making the System Work

The passage of the bill, however, was only the first step in the process of creating the Federal Reserve System. Now that Congress had acted, the Wilson Administration had to take the bare bones of the new law and put the substance of a functioning institution upon them. The number of regional reserve banks needed to be determined; their location needed to be established; lines of the various Federal Reserve districts needed to be drawn; the banks thus created needed to be staffed and opened for business; and finally, a Federal Reserve Board needed to be appointed. In appointing the Federal Reserve Board, President Wilson was to have the primary responsibility, but in establishing the regional reserve banks, others in the Administration were to have the central role.

The Federal Reserve Act designated three federal officials — the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency — to serve as the Reserve Bank Organization Committee. Their task was to designate not less than eight but not more than twelve cities to be the Federal Reserve cities, and to divide the nation into districts, each district to contain only one Federal Reserve City. The only criteria given the committee by the law declared that the districts should be drawn "with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States."

Wilson's nominee for Comptroller of the Currency — John Skelton Williams — would not be confirmed by the Senate for several weeks, so the main burden of the committee's work was carried on by the other two men. The Secretary of the Treasury, William G. McAdoo, had already played a major role in drafting the

Secretary of the Treasury William G. McAdoo Courtesy, Library of Congress

Secretary of Agriculture David F. Houston
Courtesy, Library of Congress

bill and securing its passage through Congress. McAdoo had been raised in Georgia but had become prominent as a very successful New York attorney. A widower in his late forties, McAdoo married President Wilson's younger daughter in the spring of 1914. Hard-working and extremely able, McAdoo's mind was unencumbered by rigid theories, and he was probably the dominant member of the Wilson cabinet. He was also extremely ambitious, but his strong desire to be President (many thought McAdoo was obsessed by this objective) was never fulfilled, though he was to be a strong contender for the Democratic nomination in 1924. Secretary of Agriculture David F. Houston, a brilliant classical economist, had been president of Washington University in St. Louis when Wilson named him to the Cabinet in 1913. Together, McAdoo and Houston made the key decisions in choosing the Federal Reserve cities and drawing the district lines, with Williams joining in toward the end of the final deliberations.

DISTRICT LINE DILEMMAS

In deciding on the number of Federal Reserve banks and their locations, the Reserve Bank Organization Committee faced, in miniature, the same controversies that had deeply divided Congress on banking reform for several years. "On no point," Parker Willis has written, "had there been sharper controversy than as to the issue whether banks should be four, eight, twelve, or some other number."[1]

The law provided that there would be at least eight regional banks, but those who had favored the Aldrich plan with one central bank believed that eight regional banks was far too many. Since the law was now on the statute books, they insisted that the eight should be the maximum number of regional reserve banks, and they tried to get around the spirit of the law by insisting that the Federal Reserve Bank of New York should be such a large institution as to truly dwarf the other seven regional reserve banks. In this way, the bank in New York would be a central bank in substance if not in form.

According to this scheme, the New York district would cover the entire Northeast, with the major financial centers of Philadelphia and Boston serving as branches. Smaller reserve banks would be established in Chicago and San Francisco, with even smaller banks to be located in five other cities, but these seven would largely serve as satellites of the giant institution in New York. By this approach those who had opposed — and still opposed — the regionalism of the Federal Reserve Act felt that they could get much of the form of a true central bank with a giant reserve bank in New York, while giving the advocates of a decentralized system the appearance of regionalism.

On the other hand, the rural and small town spokesmen, who had worked so hard to guarantee public control over the system, wanted to establish the maximum number of twelve regional reserve banks. Even twelve, some of them believed, might not be enough. In any

"New York and all the other Feds"
by Adam Redjinski

case, they also wanted all twelve of the regional reserve banks to be approximately the same size, with no one of them dominating the rest.

So, the controversies evident in the writing of the Federal Reserve Act were carried over into the selection of the Federal Reserve cities. Accordingly, McAdoo and Houston decided to focus initially on the determination of how many Federal Reserve banks there would be and where those banks would be located, and only after they had reached those decisions would they draw the district lines.

New York, then, became the early focal point in the controversy, for the size of the Federal Reserve bank to be established there (no one ever doubted that New York would receive a reserve bank) was a critical factor to both sides in the dispute. In the first week of January, 1914, Secretaries McAdoo and Houston spent four days in New York, hearing the arguments of the city's financial leaders for a truly gigantic Federal Reserve bank there that would completely dwarf everything else in the system. J. P. Morgan, perhaps New York's best known financier, argued that the Federal Reserve Bank of New York should be of commanding importance so that it would receive due recognition from the central banks of Europe, a view echoed by *The New York Times*. Most of the New York spokesmen wanted their bank's territory to include New England and the states just to the south of New York, while some wanted the territory to extend as far as Ohio to the west and Washington,

J.P. Morgan
Courtesy, Morgan Guaranty Trust Company

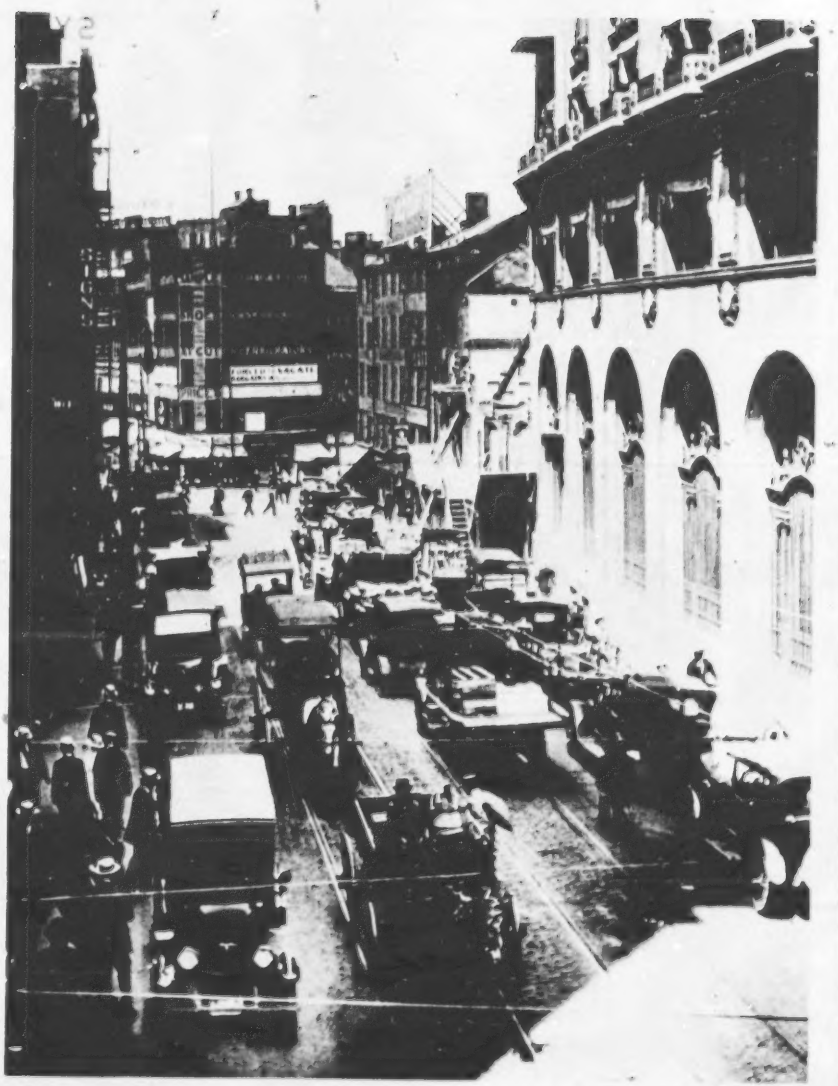
D.C. to the south. If the New York bank were to be as large as the city's financial leaders desired, it would have approximately half of the total capitalization of the entire system.

From the outset it was clear that McAdoo and Houston were not persuaded by the strong views of the New York bankers. "The present disposition of the organizers is to hobble New York," *The New York Times* lamented. The two Secretaries took the position that their purpose was not to hobble anyone but to construct a coordinated system, and that the central banks of Europe would deal with the system as a whole rather than with just one of its parts.

OPINION IN BOSTON

McAdoo and Houston then went to Boston for two days and heard a somewhat different tune. Many of the leading Boston bankers had championed the Aldrich plan with its single central bank, so ideologically they had strong reason for favoring a large New York bank of which Boston would be a branch. Yet a combination of local pride and a belief that their own financial problems should be handled locally gave them strong reason for favoring a regional reserve bank for Boston. A director of one of Boston's major banks put the dilemma well in a private letter to Secretary Houston: "If Boston were in the New York District, we should have a larger and better bank to rely on in time of stress. On the other hand, a local bank, even if not so strong, would perhaps be better acquainted with local matters and local credits, and would be more interested in helping out the local difficulties, and so might be just as useful as a stronger bank not so intimately connected with Boston." He went on to point out that many Boston bankers were perplexed by this dilemma, with local pride and regional concerns mixed with their perception of broader national issues. "I don't think that any of us are quite sure," he confessed.[2]

These doubts, however, were generally expressed in private rather than in public, and in two days of open hearings in Boston, McAdoo and Houston heard many business and community leaders urge the establishment of a reserve bank

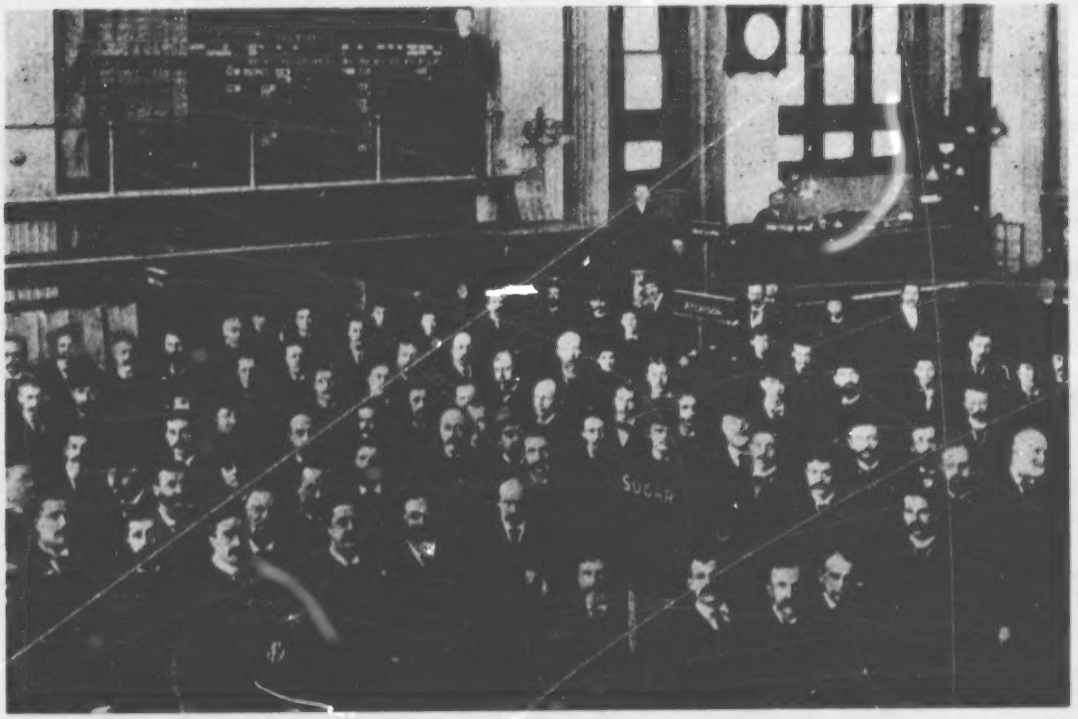


Boston's financial district in the early 1900s
Courtesy, Boston Public Library, Print Department

in Boston. It was the business, political, and academic leadership rather than the Boston bankers who spoke out the most forcibly on behalf of Boston's claims; J. Randolph Coolidge, Jr., president of the Boston Chamber of Commerce, and Professor O. M. W. Sprague of Harvard were among the most persuasive witnesses to testify before McAdoo and Houston. William A. Gaston, president of the National Shawmut Bank, also strongly championed the Boston position in public testimony.

Connecticut banks and business groups, on the other hand, made clear their desire to be associated with a New York bank rather than with a bank in Boston. The Hartford Clearing House Association, for example, declined the invitation of the Boston Chamber of Commerce to visit Boston and testify in favor of the city's claims before the Reserve Bank Organization Committee.

McAdoo and Houston then returned to Washington and heard testimony from community and business leaders representing other major East Coast cities. The argument for a large New York bank usually included Philadephia as a branch, but a delegation from the latter city traveled to Washington to press their own claims for a regional reserve bank.



Members of the Boston Stock Exchange
Courtesy, *Boston Budget*, Federal Reserve Bank of Boston Archives

CANVASSING THE NATION

On January 18, McAdoo and Houston left on a long cross-country trip that ultimately covered 10,000 miles. They visited and held public hearings in Chicago, St. Louis, Kansas City, Lincoln, Denver, Seattle, Portland, San Francisco, Los Angeles, El Paso, Austin, New Orleans, Atlanta, Cincinnati, and Cleveland. At each stop they invited local business and community leaders to testify, and they also invited spokesmen from nearby cities that they would not visit. This well-publicized trip fueled the already intense speculation in the press and among America's bankers as to what cities ultimately would be chosen. It was very clear that far more cities wanted the honor of receiving a reserve bank than the law would allow, and the Reserve Bank Organization Committee had to face the fact that no matter what it ultimately decided, many communities would be disappointed by their exclusion.

As the two men traveled across the country they heard the local, and often parochial, pleas of more than forty cities, each claiming that it should be the home of a Federal Reserve bank. "Reserve Cities are springing up all over the United States," Houston lamented to President Wilson even before the committee formally began its work. "I think the Census experts are mistaken as to the number of cities in America. Certainly nobody could have imagined that so many had strategic locations."[3]

For most of the cities making claims, the key question was probably not national economic considerations but local pride. As *The New York Times* said editorially, "The hearings of the reserve bank organizers, generally speaking, have been more remarkable for the local jealousies they have disclosed than for the perception that there was anything of national significance in the new departure." One exception, however, appeared to be the West Coast, where Los Angeles, Seattle, and Portland deferred to San Francisco as the logical site for a

San Francisco's financial district, Bush Street
Courtesy, California Historical Society, San Francisco

Pacific Coast bank. McAdoo made several public statements suggesting that the selection of the Federal Reserve bank cities was not nearly so important to the particular cities named, or to their future economic development, as most people appeared to assume.

During their travels McAdoo and Houston learned that many bankers outside of New York were not very enthusiastic about a gigantic New York Federal Reserve Bank. Many of these bankers had favored the Aldrich plan proposing one central bank, but the Federal Reserve Act's provision of at least eight reserve banks caused them to consider the factors of local pride and regional advantage.

State Street, Chicago's financial district **Courtesy, Chicago Historical Society**

St. Louis' business district
Courtesy, Missouri Historical Society

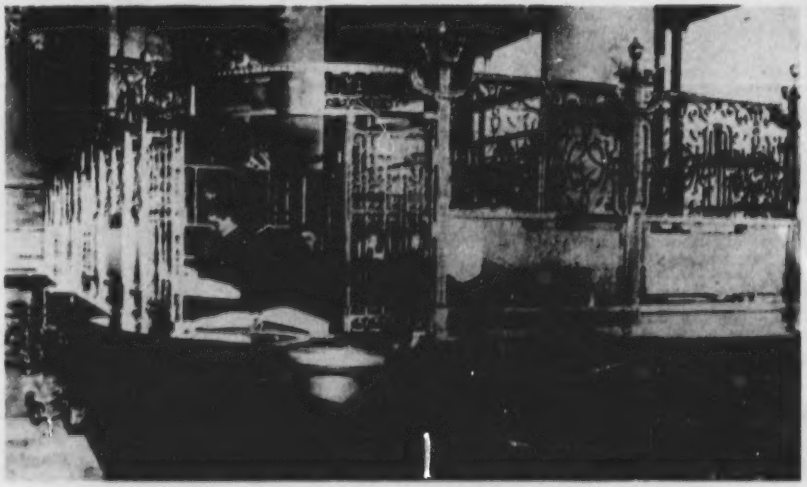
Not surprisingly, bankers in Chicago and St. Louis were especially outspoken on this point. In 1914 there were three central reserve cities: New York, Chicago, and St. Louis. Generally speaking, the bankers in the latter two cities opposed the idea of making the Federal Reserve Bank of New York such a truly gargantuan institution that it would dwarf all other reserve banks. Perhaps most bankers in Chicago and St. Louis believed that their status as a central reserve city entitled them to a Federal Reserve bank, and they wanted the bank located in their city to be somewhat comparable in size to the Federal Reserve Bank of New York, but considerably larger than the other Federal Reserve banks. Generally, the bankers in Chicago and St.

Louis wanted only eight Federal Reserve banks.

Perhaps a majority of the bankers in other cities, as well as country bankers (especially those far removed from the New York area), and those members of Congress who had been the most ardent champions of the regional approach of the Federal Reserve Act favored the creation of twelve banks. They also wanted the New York bank to be one of twelve rather than the clearly dominant member. Some went so far as to suggest that the Federal Reserve Bank of New York should cover only the lower part of Manhattan Island, with the rest of New York City belonging to other districts.

While the Reserve Bank Organization Committee was in the process of selecting reserve bank cities, it was very much concerned with the question of membership in the Federal Reserve System among the nation's commercial banks. The Federal Reserve Act required all national banks to join the system (or forfeit their national charter), and it allowed state banks to join the system if they wished and if they met certain requirements of liquidity and soundness. Yet fresh in the memory of McAdoo, Houston, and John Skelton Williams was the fact that a majority of the nation's bankers had opposed the Federal Reserve Act, many of them specifically opposing mandatory membership for the national banks. They had reason to fear that many of the national banks would surrender their charters rather than join the system.

Accordingly, the Reserve Bank Organization Committee was extremely solicitous of the opinion of the national banks. Early in 1914 the committee polled all the national banks in the country on their preference for a Federal Reserve city with which they would be affiliated, giving them the opportunity to make a first, second, and third choice. The banks, of course, had no idea what the final Federal Reserve district lines might be, so several of them selected as their choice of location of a Federal Reserve bank a city that was not in their final district. (Indeed, four banks in California listed New York City as their second choice.) There is strong reason to believe that this poll of national banks was the most important single factor in determining the cities that received Federal Reserve banks.



Teller windows at the Union Trust Company, San Francisco
Courtesy, Wells Fargo Bank, History Room, San Francisco

HELLO, BOSTON — GOODBYE, BALTIMORE

Many minor cities received only a scattering of votes (Sioux City, Iowa and Springfield, Massachusetts, for example). By weighing each national bank's preferences as to first, second, and third choice, the committee finally came up with a list of the twelve cities with the most substantial support: Atlanta, Boston, Chicago, Cincinnati, Dallas, Kansas City, Minneapolis, New York, Philadelphia, Richmond, St. Louis, and San Francisco.

On April 2, 1914 the Reserve Bank Organization Committee announced its decision. Eleven of the twelve cities attracting the greatest support in the national poll received Federal Reserve banks. The only city which did not was Cincinnati, which was included in the district belonging to the Federal Reserve Bank of Cleveland. Within each of the newly designated Federal Reserve districts, the Federal Reserve city had received the most support from the national banks within its district, again with the sole exception of Cleveland; within that district both Cincinnati and Pittsburgh had generated more support.

Boston's Park Street from the steps of the State House
Courtesy, *Boston Budget*, Federal Reserve Bank of Boston Archives

In an accompanying statement the Reserve Bank Organization Committee outlined the basic criteria with which it justified its selections:

1. The ability of member banks within the district to provide the minimum capital — $4,000,000 — required for each Federal Reserve bank by the law.
2. The mercantile, industrial, and financial connections existing within each district.
3. The probable ability of the Federal Reserve bank in each district to meet the legitimate business demands placed upon it.
4. The fair and equitable division of the available capital for the Federal Reserve banks among the districts.
5. Geographical factors, and the existing network of transportation and communication.
6. Population, area, and prevalent business activities of the districts.

The fourth listed consideration — the fair and equitable division of the available capital among the Federal Reserve districts — was another way of stating the committee's basic dilemma: the number of banks to be created and the size of the New York bank. The rural and agrarian spokesmen, as well as the smaller country banks and some big city institutions, had prevailed in their desire that twelve banks be created and that the size of the New York bank be somewhat limited. Even though the New York bank was limited to New York State alone (its district lines, and some others, were slightly modified in the following years), the New York bank with just over $20,000,000 in capital stock had nearly four times the capitalization of the smallest banks, Atlanta and Minneapolis with just under $5,000,000 in capital stock.

Under the law each of the member banks would subscribe to the capital of its district Federal Reserve bank an amount equal to six percent of its own capital and surplus, and each Federal Reserve bank was required to have a capitalization of at least $4,000,000. If the capital stock of each of the Federal Reserve banks had been made approximately equal, however, the New York bank would have included only a small part of Manhattan Island, and the already enormous geographical size of the Atlanta and Minneapolis districts would have been considerably larger. In such a case, moreover, parts of New York City would have been included in other districts (probably Boston, Philadelphia, and Cleveland, at least), and the size and shape of the other districts would have probably been more grotesque than the wildest dream of the most enthusiastic gerrymanderer. Given the overwhelming size of New York's financial resources, it was quite impossible to prevent the New York bank from being the largest and most dominant bank in the system, but it was considerably smaller than the New York banking community had wanted.

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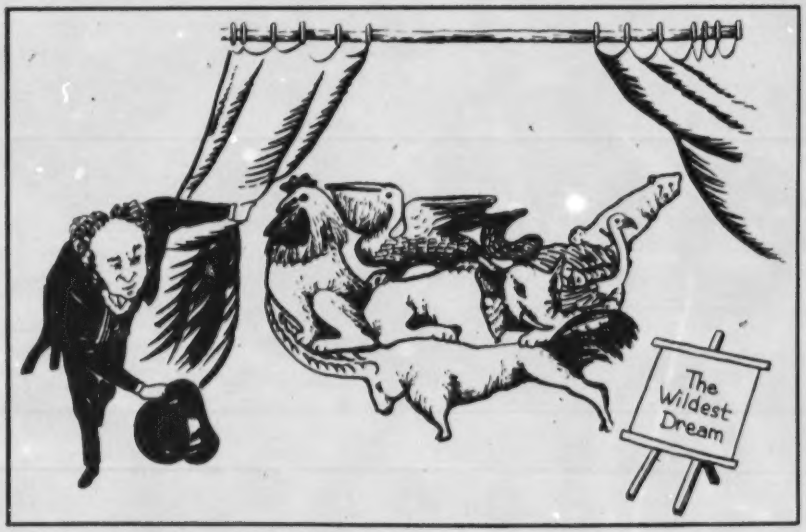
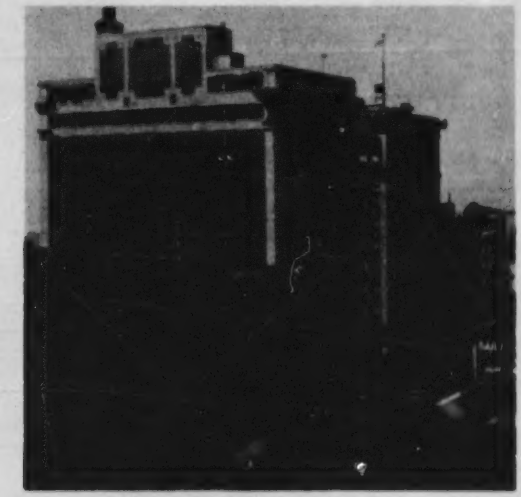


"The wildest dream of the most enthusiastic gerrymanderer"
by Adam Redjinski

The Reserve Bank Organization Committee's statement suggested that the district lines had been drawn first and the cities selected after that, but in reality the process had been just the reverse: the cities were selected and then the district lines were drawn around them. There is also little indication that the committee had ever seriously considered choosing fewer than twelve cities. Given the inclination of McAdoo and Houston to disagree with the position of the New York bankers, such a result was not surprising. Moreover, with more than forty cities making strong claims to be designated, the committee was able to satisfy more of them by choosing the maximum number of cities allowable. In following very closely the results of the poll among national banks, the committee was in a position to demonstrate that the new Federal Reserve System was anxious to work with bankers rather than to face them in angry confrontation.

Naturally the smaller cities which had been named were overjoyed by their selection. "I have always said you and Houston were great men," a prominent Kansas City business leader told McAdoo. "Now there isn't a man in Kansas City to dispute it."[4] Dallas and Richmond found their status in American banking greatly enhanced by their selection. Under the national banking system there were three central reserve cities and 47 reserve cities; theoretically, these fifty cities were the most important in American banking, but among them were, for example, Waco, Texas and Cedar Rapids, Iowa. Dallas and Richmond, however, had not been reserve cities, so their selection as sites for regional Federal Reserve banks increased their stature as regional financial centers.

Downtown Kansas City



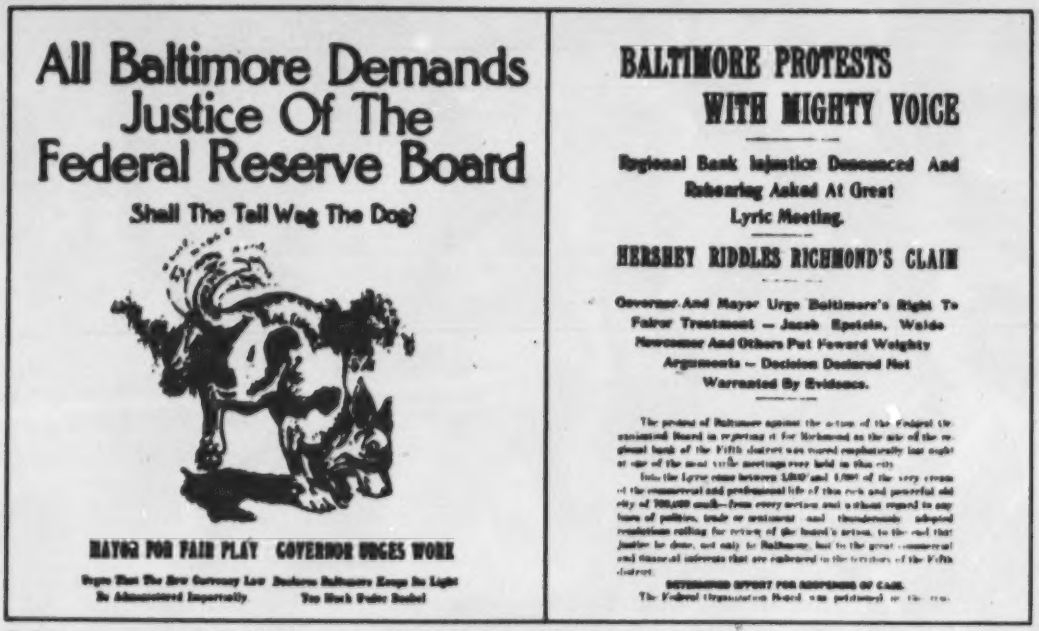
Courtesy, Kansas City Public Library, Missouri Room

CROSSFIRE

Yet in the wake of the committee's announcement the voices which came through most loudly were not of gratification but of outrage. Lincoln, Nebraska protested its exclusion, but no one really paid much attention to that. Far more significant complaints came from two undeniably major cities which had not been designated — New Orleans and Baltimore. Both were considerably larger than some of the smaller cities selected (Richmond, Dallas, Atlanta, Kansas City, and Minneapolis) and both responded to their exclusion with mass protest demonstrations. New Orleans, whose selection as a Federal Reserve city had been expected by bankers from all over the country, held a mass meeting on Sunday evening, April 5, protesting the committee's decision and demanding that it be reconsidered so that New Orleans could get a bank. Baltimore's protest was perhaps even more spectacular. On April 15 the financial, business, and civic leadership of the city, along with hundreds of others, crowded the Lyric Theatre and heard the Mayor of Baltimore and the Governor of Maryland vigorously denounce the committee's decision to pass over their city and name Richmond instead.

Not only did the Reserve Bank Organization Committee receive much criticism for the cities it did not name, but it also heard loud complaints about some of the cities it did select. H. Parker Willis, who had assisted the committee in its work, believed that Richmond was the selection most difficult to justify. It was

This cartoon of protest appeared in the New Orleans *Daily Picayune*
Courtesy, New Orleans Public Library



All Baltimore Demands Justice Of The Federal Reserve Board

Shall The Tail Wag The Dog?

MAYOR FOR FAIR PLAY GOVERNOR URGES WORK

BALTIMORE PROTESTS WITH MIGHTY VOICE

Regional Bank Injustice Denounced And Rehearing Asked At Great Lyric Meeting.

HERSHEY RIDDLES RICHMOND'S CLAIM

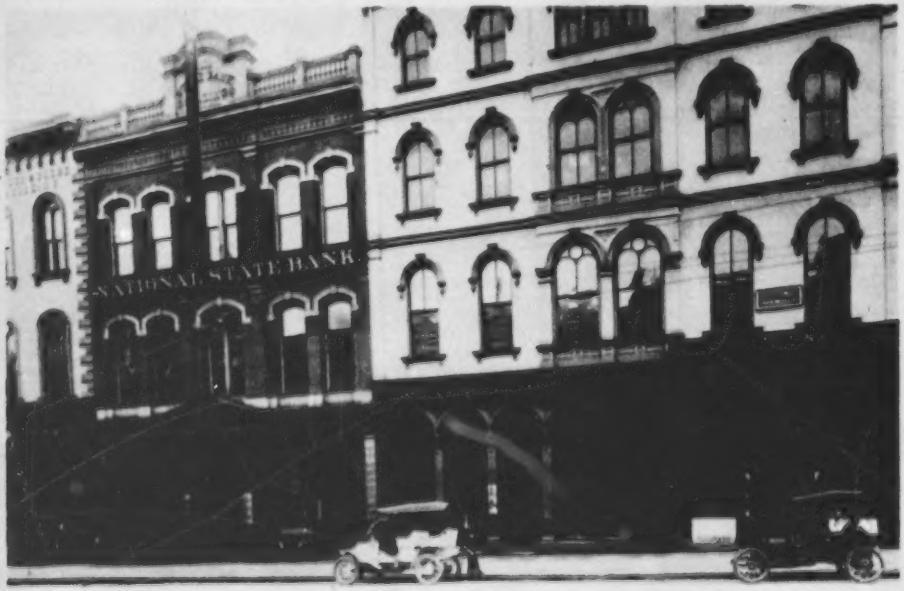
Governor And Mayor Urge Baltimore's Right To Fairer Treatment — Jacob Epstein, Waldo Newcomer And Others Put Forward Weighty Arguments — Decision Declared Not Warranted By Evidence.

Baltimore protests the choice of Federal Reserve cities in the *Baltimore Sun*, April 16, 1914
Courtesy, Baltimore Public Library

one of the smaller cities so designated, and many doubted the need for two Federal Reserve districts (Atlanta and Richmond) in the Southeast. Moreover, Richmond's selection lay open to the charge that it was a case of political favoritism, for Carter Glass was a Virginian and John Skelton Williams, Comptroller of the Currency and one of the three committee members, was from Richmond itself. Cleveland's selection was questioned because Cincinnati and Pittsburgh had received more support from the national banks within the district, and because it was the home of Secretary of War Newton D. Baker, an unusually prominent member of the Wilson Cabinet. There was some criticism of the selection of both St. Louis and Kansas City because both are in Missouri, a state with enormous political influence in the Wilson Administration. The Speaker of the House, Champ Clark, was from Missouri (he had nearly beaten Wilson for the Democratic nomination in 1912); Senator James Reed, from Kansas City, was one of the most prominent men in the upper house; and Secretary of Agriculture David F. Houston, one of the three members of the Reserve Bank Organization Committee, came to his cabinet position from St. Louis.

These questions of political favoritism in the selection of Federal Reserve cities (especially Richmond and the two in Missouri) led to several days of debate in the House of Representatives. After hearing much intense criticism, Carter Glass sprang to the defense of the committee and its selections, and he suggested that the importance of Federal Reserve banks to the cities in which they would be located had been overemphasized. He also denied playing any role in the selection of Richmond. President Wilson also came to the committee's defense while stoutly maintaining that he had offered the committee no suggestions.

Stung by this criticism from around the country and within Congress, the Reserve Bank Organization Committee made public the poll of national banks, hoping to demonstrate that any favoritism shown had not been to politicians but to banking opinion. A few days later, on April 10, the committee issued a lengthy statement defending its choices. Attempting to mollify the disappointed cities, the committee argued that designation or the failure to designate any particular city would not be important to that city's future, and that the normal patterns of business and banking would not be affected by the creation of the twelve Federal Reserve districts. "Every city which has the foundations for prosperity and progress will continue to grow and expand, whether it has such a reserve bank or not, and well-informed bankers, especially, are aware of this," the committee said.



This "Bank Street" is really the 1100th Block of East Main Street, Richmond

Courtesy, Cook Collection, Valentine Museum, Richmond, Virginia

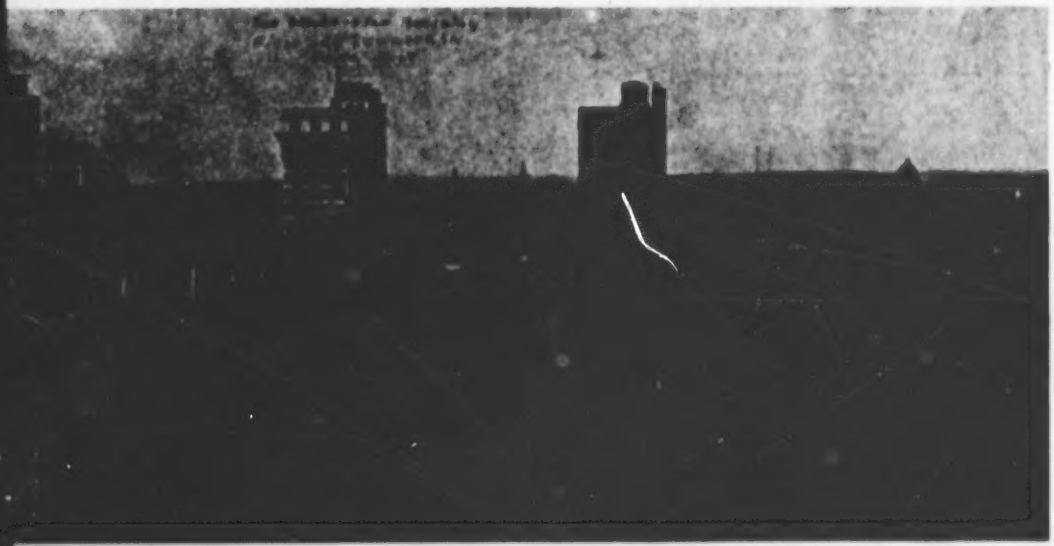
Moving on to defend its most controversial selections, the committee suggested that it chose the twelve cities that it did because they were the most important in terms of banking resources, central location, and communication and transportation facilities. Though Dallas, Atlanta, and New Orleans had comparably sized bank business, the committee thought it especially noteworthy that the banking business of both Atlanta and Dallas had more than doubled in the past decade while the banking business of New Orleans had remained stable. In addition, Dallas and Atlanta were the overwhelming choice of the banks in their regions, while it was generally only the Louisiana banks that favored New Orleans. As for Richmond, the committee pointed out that banks in the district preferred it over Baltimore, and that it was more centrally located while Baltimore was at the northern edge of the district and very close to Philadelphia. While Baltimore's banking resources were clearly greater than those of Richmond, the latter's had grown five times more rapidly during the past decade. As for Kansas City, the committee again pointed out that it, far more than any other city in the district, had been the choice of the national banks. None of the other major cities in the district — Denver, Omaha, or Lincoln — even came close to the banking resources of Kansas City.

The committee's statement contained some inconsistencies. On the one hand it argued that failure to receive a Federal Reserve bank did not mean that a particular city lacked importance or that its future growth would suffer; on the other hand, the committee justified its

An overall view of Dallas
Courtesy, Dallas Historical Society

most controversial choices by arguing that the cities selected were, in fact, more important in terms of location, banking resources, and future potential than their disappointed rivals.

Controversies about the cities selected and some of the district lines would persist for several years. From time to time the Federal Reserve Board has slightly modified some of the district lines, but none of these changes were major. Perhaps the most noteworthy occurred in 1916, when the Board moved Fairfield County, Connecticut from the Boston district to the New York district, and the northern New Jersey counties from the Philadelphia district to the New York district. This change was made at the request of the local bankers, who had been very unhappy about their exclusion from the district of the Federal Reserve Bank of New York. More important, however, the twelve cities originally named by the committee have retained their Federal Reserve banks, and after the System had been in operation for only a few years no serious challenge arose against any of them. In short, despite the outcry from many quarters, the decision announced by the Reserve Bank Organization Committee on April 2, 1914, has not been changed.



GETTING IT TOGETHER

After choosing the twelve Federal Reserve cities and drawing the district lines, the Reserve Bank Organization Committee had to bring the more than 7,000 national banks into formal membership in the new system, and it had to provide for the organization of the twelve Federal Reserve banks. Also, the President had to nominate five members to the Federal Reserve Board who would be acceptable to the Senate. Until these major actions were taken America's new experiment in central banking could not begin.

During the debate over the Federal Reserve Act in Congress, and soon after its passage, there had been many fears that the vocal opposition of most of the banking community would mean that large numbers of national banks would give up their charters rather than join the Federal Reserve System. Yet these fears never materialized. In fact, only a very few national banks took this step. Following the passage of the Federal Reserve Act many bankers either reconciled themselves to the new system, with the determination to make it work well, or came to accept that the Federal Reserve Act contained many benefits and improvements that they had not fully appreciated before.

A few days after final congressional passage of the bill, a director for a major Boston bank expressed his own change of opinion in a letter to David Houston: "I hardly need to tell you that the attitude of our Directors — and I presume this has been the experience in every bank — has changed completely in regard to the currency bill. They started out with a strong prejudice against it, and a feeling that it would almost be necessary to keep out of the system, even if that meant reorganization [that is, replacing the national charter with a state charter]; but the very great improvement which the bill cannot help effecting in our currency situation has gradually impressed itself upon us, and, in addition, the progressive changes which have been made in the bill have created a very favorable impression. I don't meet anybody now who, whatever his views as to possible dangers, does not feel that the advantages outweigh the dangers."[5]

The Federal Reserve Act had specified that the national banks had sixty days after the passage of the law to indicate their acceptance of it, and within a month more than two-thirds of them had done so. By the end of February, 1914, just after the expiration of the sixty day period, it was clear that more than 99 percent of the national banks had accepted the new law and had joined the System in order to retain their national charters. The Federal Reserve Act also allowed state chartered banks to apply for membership, but in 1914 the Organization Committee gave very little attention to this issue. By April, only seventy-three state chartered banks in the nation applied for membership. It was not until after the System actually began functioning that the Federal Reserve

Board gave any serious consideration to this question. In New England, there were no state chartered members until August, 1915.

Under the Federal Reserve Act all member banks had to subscribe to an amount of stock in their own regional Federal Reserve bank equal to six percent of their capital and surplus. By May 5 national banks had subscribed the minimum required capitalization of $4,000,000 in each of the twelve districts, so the committee formally selected five national banks in each district to organize the regional reserve bank and expressed the hope that the twelve banks would be able to open for business by August 1. In New England the five selected were: First National Bank, Bridgeport, Connecticut; Casco National Bank, Portland, Maine; National Shawmut Bank, Boston; First National Bank, Concord, New Hampshire; and the National Bank of Commerce, Providence, Rhode Island. It was up to the five banks in each of the twelve districts to execute the formal certificate of incorporation, and this was done on or just after May 18 in all twelve districts.

Newsclipping announces the opening of the Boston Fed
Courtesy, Federal Reserve Bank of Boston Archives

ELECTING LOCAL DIRECTORS

The next step was for the member banks to elect six of the nine members of the Board of Directors for each Federal Reserve bank. Following the specific provisions of the law, the Reserve Bank Organization Committee divided the member banks within each district according to capitalization: the largest one-third in one grouping, the middle one-third in a second grouping, and the smallest one-third in a third grouping. Of the six directors elected by the member banks, three were to represent the banks themselves (Class A Directors) while the other three were to represent the commerce, agriculture, or industry of the district while having no connection with a commercial bank (Class B Directors). Each of the three groupings of member banks would elect one Class A Director and one Class B Director. In other words, each member bank would have a vote in the selection of only two of the nine members of the Board of Directors.

Governor Alfred L. Aiken,
Federal Reserve Bank of Boston
Courtesy, Federal Reserve Bank of Boston

The final three directors (Class C Directors) for each Federal Reserve bank were to be appointed by the Federal Reserve Board, one of the Class C directors being designated chairman and another Class C director being designated vice chairman. Under the Federal Reserve Act the Secretary of the Treasury and the Comptroller of the Currency were *ex-officio* members of the Federal Reserve Board, while the other five members were to be appointed by the President and confirmed by the Senate for ten-year terms. (The Banking Act of 1935 changed the composition of the Board, which was officially renamed the Board of Governors of the Federal Reserve System. Under this new law the Board was to consist of seven members, each of whom would be appointed by the President and confirmed by the Senate for fourteen-year terms; the Secretary of the Treasury and the Comptroller of the Currency no longer served on the Board.)

WILSON'S CHOICES: THE FEDERAL RESERVE BOARD

President Wilson waited until the Organization Committee had selected the cities and had drawn the district lines before he announced his choices for the Federal Reserve Board. For one thing, only one of the appointed members of the Board could come from any one Federal Reserve district, so clearly the lines had to be drawn before the appointments could be made. Moreover, Wilson's five appointments were among the most important he had been called upon to make in his presidency, and it took some time for him to make his choices.

On May 4 the President sent his five nominations to the Senate. They were: Richard Olney, conservative Boston lawyer and Secretary of State under Grover Cleveland twenty years earlier; Harry A. Wheeler, Chicago businessman and former president of the United States Chamber of Commerce; Paul M. Warburg, partner in the Wall Street investment firm of Kuhn, Loeb & Company, and an opponent of the Federal Reserve bill while it was before Congress; Adolph C. Miller, a former professor of economics at the University of California; and William P. G. Harding, president of the First National Bank of Birmingham, Alabama, and a champion of his own city as the site for a Federal Reserve bank.

Almost as soon as Wilson named his choices he faced embarrassment. Olney was probably the most prominent of the nominees, but his stewardship of the State Department had been filled with controversy, and, citing his advanced age as the reason, he declined the appointment. Wheeler also turned down the offer.

The President's embarrassment soon turned into a nasty political confrontation with the Senate. While Wilson's selections proved very popular among America's banking leaders, the President's natural political allies — the progressives — were deeply and bitterly disappointed. Within Wilson's official family Secretary McAdoo strongly advocated the appointment of a Board which would work with him to break what he considered to

Richard Olney
Courtesy, Library of Congress

Harry A. Wheeler
Courtesy, Library of Congress

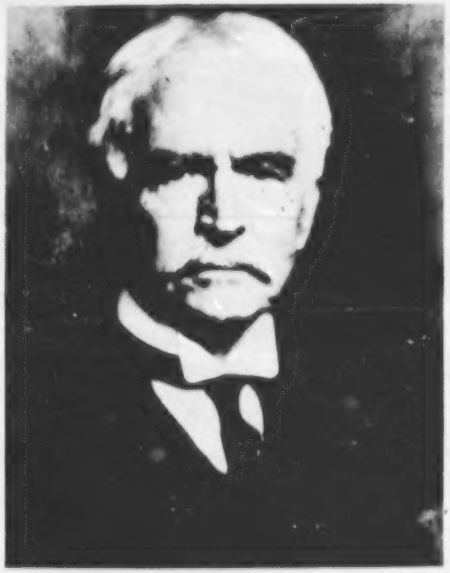
Colonel Edward M. House
Courtesy, Library of Congress

be Wall Street's control over the nation's credit. The President rejected McAdoo's argument in favor of the position of Colonel Edward M. House, Wilson's most important adviser. House advocated the selection of men who would win the confidence and cooperation of the banking community, and the President gave him a free hand to consult widely among conservatives and among the banking leadership for suggestions.

The progressives were appalled by the nominations, and the pleasure expressed by bankers and conservatives only deepened their suspicions. After Olney and Wheeler declined appointment, Wilson on June 15 named in their place Charles S. Hamlin, a Democrat from Boston, and Thomas D. Jones, a businessman from Chicago. These replacements, particularly Jones, only angered the progressives further. Led by Senator James Reed of Missouri, the progressives directed more of their fire at Warburg and Jones. Warburg was suspect because he represented a prominent Wall Street investment house and because he had been a strong champion of that *bete noir* of the progressives, the Aldrich plan. Jones was suspect because he was a director of the International Harvester Company, a trust which was universally hated by the middle western farmers and progressives, and which was under both state and federal indictment in 1914 as an illegal business combination in restraint of trade. Wilson was particularly embarrassed and embittered by the

opposition to Jones, for the latter was an old friend who had sided with him during his controversies as president of Princeton University and who had contributed large sums of money to his presidential campaign of 1912. Moreover, Jones had reluctantly accepted the appointment only after Wilson had appealed to him on the basis of their friendship.

President Wilson decided to fight vigorously for the Senate confirmation of his five choices, and he came out with particular force for his old friend Jones. He argued that Jones, as a director of International Harvester, had been working to end the activities which had brought that company under indictment. In July, Jones testified before the Senate Banking Committee, which was holding hearings on the President's five nominations, and he weakened his own case by showing more sympathy with the policies of International Harvester than Wilson had suggested was the case. A few days later the committee voted, seven to four, to disapprove Jones's nomination. Infuriated, Wilson determined to carry his fight for his friend's confirmation to the Senate floor. Despite very heavy Administration pressure, a number of Democratic senators normally aligned with Wilson refused to accept Jones. The President, seeing that his friend could not prevail in a Senate vote, asked him to withdraw his nomination. Jones, who had not been eager to serve on the Federal Reserve Board in the first place, gladly complied. This was Wilson's first defeat at the hands of either house of Congress.



Thomas D. Jones
Courtesy, International Harvester, Chicago

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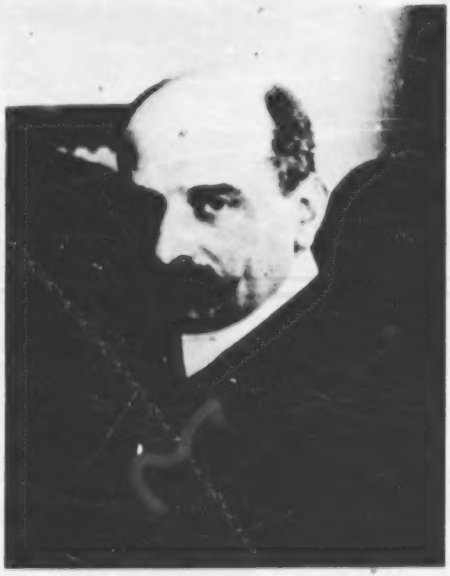


Paul M. Warburg
Courtesy, Library of Congress

As a replacement for Jones, the President nominated Frederic A. Delano, president of the Monon Railroad, and he was easily confirmed by the Senate.

Meanwhile the Senate Banking Committee had also requested Warburg to appear before it. Warburg's pride was so wounded by this request — he seemed to feel that he was being asked to appear at an inquisition — that he requested the President to withdraw his nomination. Wilson refused to do so and pleaded with Warburg to appear before the committee as Jones had done. Senator Hitchcock assured Warburg that he would be treated kindly. In early August, Warburg finally consented to testify, and he was promptly approved by the committee and confirmed by the Senate. Apparently the defeat of Jones, and Warburg's ultimate appearance before the committee, was victory enough for the progressives, for they made no serious attempt to block confirmation of Wilson's three other selections. Perhaps most significantly, Wilson's appointments to the Federal Reserve Board were very welcome to the banking community, and they indicated that the President wished to inaugurate the Federal Reserve System in cooperation with the financial community of the nation.

Members, Federal Reserve Board. Left to Right: W.G. McAdoo, John Skelton Williams, A.G. Miller; F.O. Delano, H. Parker Willis, W.P.G. Harding; P.M. Warburg; and C.S. Hamlin
Courtesy, Federal Reserve Board of Governors, Washington, D.C.

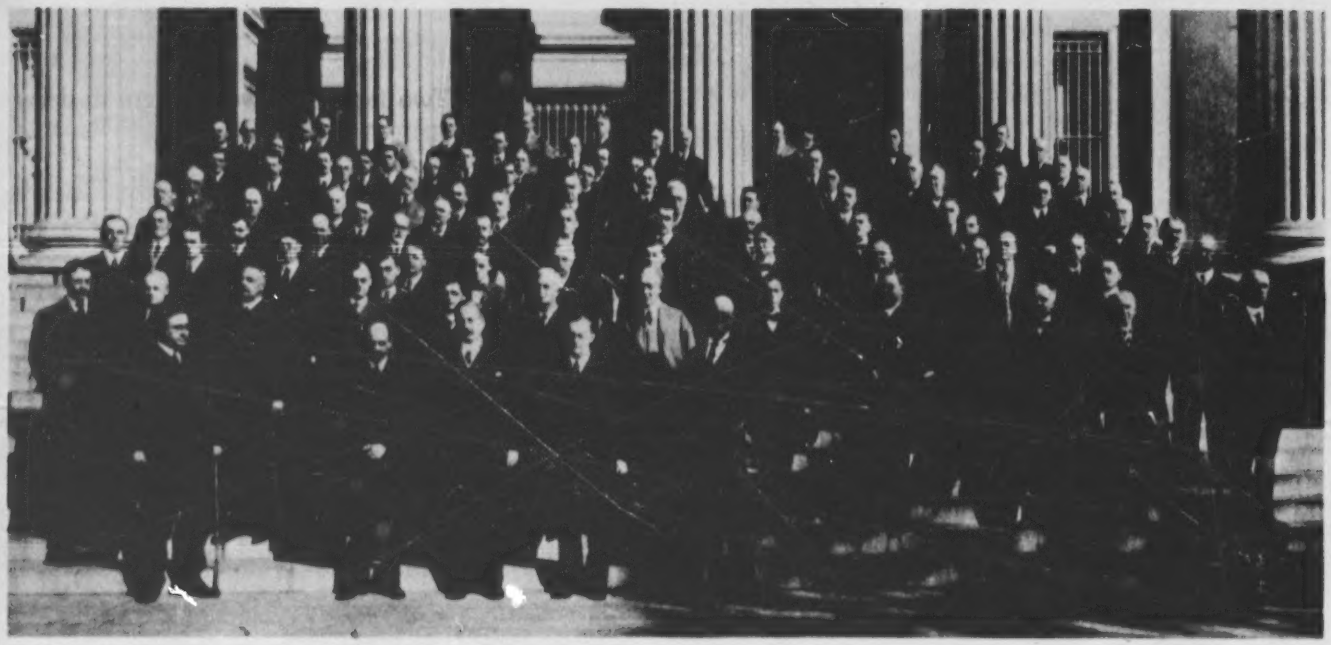
On August 10, 1914, the Federal Reserve Board was officially sworn into office, with Charles S. Hamlin designated Governor (i.e., chairman), and Frederic A. Delano, Vice Governor, and it took over the work that had been started by the Reserve Bank Organization Committee. Two factors, however, were to delay the opening of the new Federal Reserve Banks. One was the slowness of the member banks in electing the six Class A and Class B directors. The other was the beginning of World War I in Europe; the outbreak of war had such a profound impact upon American business and banking that it made it even more difficult to open the reserve banks yet far more essential that they be opened as soon as possible.

The newly appointed Board had to appoint the three Class C directors for each of the twelve banks. It also worked on drafting by-laws for the twelve banks, so that the banks could be as uniform as possible. Many other details and technical considerations occupied the Board's attention: the staffing of each of the

banks, with the selection of officers; the provision of office space; precise guidelines for the kind of commercial paper which member banks could rediscount, and a workable mechanism for the rediscount of such paper; the design and printing of the new currency, Federal Reserve notes; and finally, provision for the transfer of reserves from the central reserve and reserve city banks to the new Federal Reserve banks.

Some of the Federal Reserve banks were moving ahead more rapidly than others, and the Board seemed willing to open each bank as it became ready. However, Treasury Secretary McAdoo decided that the banks should all open for business at the same time. McAdoo's determination put pressure on the Federal Reserve Board to name all of the Class C directors speedily and on the slower banks to prepare for an early opening.

On October 20, after all of the Class C directors had been named, all nine directors from all twelve banks met in Washington to prepare for the opening of the banks. By this time the Federal Reserve Board had come to accept McAdoo's determination that all twelve banks open at the same date. The various directors, however, could not agree what the specific date ought to be.



Directors from the twelve Federal Reserve banks meeting in Washington, D.C.
Courtesy, Federal Reserve Bank of Boston Archives

Sixty-third Congress of the United States of America;

At the Second Session,

Begun and held at the City of Washington on Monday, the first day of December, one thousand nine hundred and thirteen.

AN ACT

To provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the short title of this Act shall be the "Federal Reserve Act."

Champ Clark,

Speaker of the House of Representatives.

Thos. R. Marshall

Vice President of the United States and President of the Senate.

Approved 23 December, 1913.

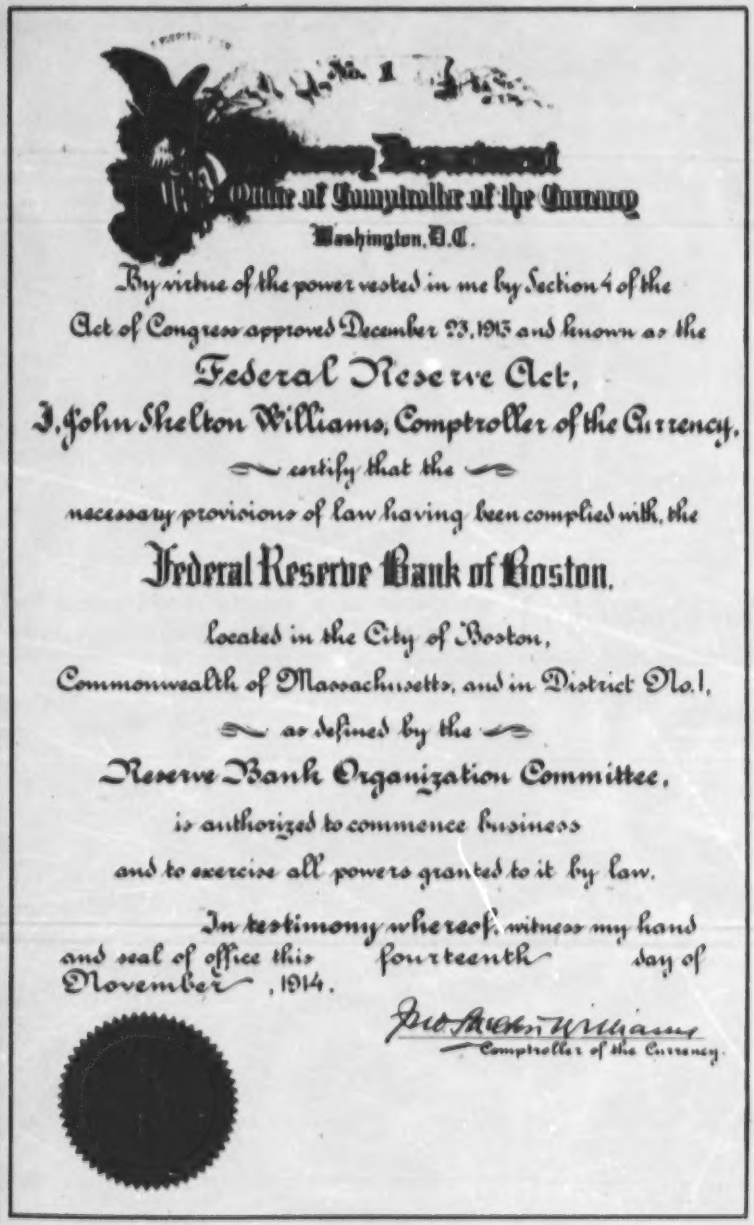
Woodrow Wilson

Facsimile of portions of first and final pages of Federal Reserve Act of 1913

A few days after the Washington meeting McAdoo himself publicly announced that the Federal Reserve banks would all open on Monday, November 16. He also said that as soon as the twelve banks were opened, the federal government would transfer as much of its government funds as possible to the various reserve banks.

On November 16 the twelve Federal Reserve banks started operations with little fanfare and, in some cases, with less business. In no case had permanent quarters been arranged, and in many quarters there was a very large question of how long the Federal Reserve System would last. In most of the banks a clerk or two oversaw the small trickle of business, and their work was often seen somewhat as a novelty. The Federal Reserve Bank of Boston began operations in rented quarters at 101 Milk Street, approximately the location of the permanent building, with expansions, that the bank was to occupy from the early 1920s through the middle 1970s.

Inauspicious as it was, November 16, 1914 — the opening of the Federal Reserve Banks — marks the end of this story. In the sixty years that have passed those banks have remained in operation, and their activities and responsibilities have expanded enormously. With the passage and implementation of the Federal Reserve Act, the United States had initiated the central banking system which persists today — to serve and add stability to the commercial banking system and to monitor and influence the American economy.



No. 1

Treasury Department

Office of Comptroller of the Currency

Washington, D.C.

By virtue of the power vested in me by Section 4 of the Act of Congress approved December 23, 1913 and known as the

Federal Reserve Act,

I, John Skelton Williams, Comptroller of the Currency,

certify that the

necessary provisions of law having been complied with, the

Federal Reserve Bank of Boston,

located in the City of Boston,

Commonwealth of Massachusetts, and in District No. 1,

as defined by the

Reserve Bank Organization Committee,

is authorized to commence business

and to exercise all powers granted to it by law.

In testimony whereof, witness my hand and seal of office this fourteenth day of November, 1914.

John Skelton Williams

Comptroller of the Currency

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Comptroller of the Currency, John Skelton Williams, authorizes the Federal Reserve Bank of Boston to commence business

Courtesy, Federal Reserve Bank of Boston Archives

Footnotes

INTRODUCTION

1. Arthur S. Link, *Wilson: The New Freedom* (copyright © by Princeton University Press), p. 238. Reprinted by permission of Princeton University Press.
2. Richard Hofstadter, *The Age of Reform*, New York, Knopf, 1955, p. 23.

CHAPTER 2

1. David F. Houston Papers, Houghton Library, Harvard University, p. 37.
2. Link, *op. cit.*, p. 212.
3. Link, *op. cit.*, p. 218.
4. Link, *op. cit.*, p. 220.

CHAPTER 3

1. H. Parker Willis, *The Federal Reserve System*, Washington, D.C., Board of Governors, Federal Reserve System, p. 561.
2. Houston Papers, *op. cit.*, letter from Roland W. Boyden, a lawyer with Ropes, Gray and Gorham and a director of the First National Bank of Boston, to David F. Houston, December 27, 1913.
3. Houston Papers, *op. cit.*, letter from Houston to President Wilson, December 29, 1913.
4. William G. McAdoo Papers, Manuscript Division, Library of Congress, Washington, D.C., letter from William Rockhill Nelson to McAdoo, April 3, 1914.
5. Houston Papers, *op. cit.*, Roland W. Boyden to David F. Houston, December 27, 1913.

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